— THE —

CANADIAN CHARTERED ACCOUNTANT

Volume XXXVII JULY, 1940 Number 1

CONTENTS

Publication Office: — 10 Adelaide Street East, Toronto

The Canadian Chartered Accountant

OFFICIAL ORGAN OF

THE DOMINION ASSOCIATION OF CHARTERED ACCOUNTANTS

Published monthly; subscription $2.00 per annum in advance. Advertising rates sent on request.

The Editorial Committee will be pleased to receive contributions on subjects of interest. Papers which may not be deemed suitable will be returned, if desired.

AUSTIN H. CARR, Editor,
10 Adelaide Street East, Toronto

VOLUME XXXVII, No. 1 JULY, 1940 ISSUE No. 204

(The opinions expressed in articles in The Canadian Chartered Accountant are the opinions of the writers of the articles and are not necessarily endorsed by the Association.)

THE DOMINION ASSOCIATION OF CHARTERED ACCOUNTANTS

ANNUAL MEETING

Since publication of the notice of the next Annual Meeting of the Association in the June issue of THE CANADIAN CHARTERED ACCOUNTANT, it has been decided to shorten the period of this meeting to the following:

All day, September 3—Meeting of Council

Morning, September 4—Meeting of Council, continued

Afternoon, September 4—Meeting of Committee on Education and Examinations

Morning, September 5—Annual meeting of Members

Afternoon, September 5—Annual meeting, continued, and final meeting of Council.

Kenneth W. Dalglish,
President.

Montreal,
20th June 1940.

Editorial Comment

(Contributed)

The Late Minister of National Defence

The death of Norman MacLeod Rogers was received by the people of Canada as the loss not only of the man who epitomized Canada's war effort but also as that of a man, young in political years, in whose courage, integrity and ability men and women of all parties or of no party had essential faith and who, for that reason, seemed destined to render great service to the cause of true democracy in the country which he loved so well.

The public life of Canada has lost a mortal servant. It has gained the enduring memory of a noble spirit which despised the doctrines of hatred and might in all their manifestations and which had fought bravely and honourably for all the values which hatred and might are now striving to destroy. We can best pay tribute to that memory by taking to heart in these dark hours the last words which Norman Rogers wrote but was not to speak: "Let us never for a moment lose confidence in final victory. Our clearest light at this time is in the undying conviction that the forces of tyranny and oppression cannot prevail . . . . In this faith we will fight on, we will endure and we will win."

Financial Periods

There has been a good deal of discussion in recent years of the appropriate date for ending the annual financial periods of commercial concerns. This should not blind the world to the fact that neither in commercial nor institutional accounting is the year the only period for which financial statements can be and are prepared, and that it is accordingly necessary to specify at the head of any operating statement the period of time to which it relates. We are prompted to make these observations because a few days ago we received a report upon the finances of one of the largest voluntary war service organizations containing an income and expenditure account "for the period ending 31st December 1939." Nowhere in this or the supporting statement was there either explicit or implicit information from which the reader could deduce the "period" in question. He will no doubt guess that a year's operations are covered but in

matters of this kind we think it should not be necessary for him to do any guessing. It is only fair to add that the statement under criticism was not one prepared or certified by a member of the profession but was apparently a summarization of the audited statement prepared by the organization itself for purposes of publication. It would seem to be most desirable that in all cases where this type of summarization is undertaken the auditor should be consulted especially when, as in this case, his name is mentioned.

War Savings Certificates

In the last great emergency of the war of 1914-1918 the war savings certificate proved a welcome investment opportunity for those with small means and a satisfactory source of loan funds for the government. The new issue recently announced by the Minister of Finance is offered in denominations of five, ten, twenty-five, fifty and one hundred dollars to yield three per cent and to mature seven and a half years from the date of issue. To bring the saving plan within the range even of the very young people of Canada twenty-five cent war savings stamps are being issued and when sixteen of these have been bought and pasted on a sheet provided for the purpose the sheet will be exchanged for a fully paid five dollar certificate. The present scheme is thus the exact counterpart of that of 1918 except that the maturity was then five years from the date of issue instead of seven and a half.

The certificates are expressly designed to attract the savings of those who cannot afford to subscribe to war bonds of larger denominations and accordingly it is provided that no one may hold them in excess of a total maturity value of $500 bought in any one calender year. Since the interest increment is not subject to income tax it is to be anticipated that, to the limit of this restriction, the sale of certificates will be swelled by the orders of those who are fortunate enough to be income tax payers. Moreover, since the people as a whole are much more familiar today than they were a quarter of a century ago with the process of investment, it can confidently be predicted that the total issue will greatly exceed that of the earlier period which amounted at 31st March 1920 to ten million dollars for war

savings certificates, war savings stamps and thrift stamps combined.

The war savings certificate provides a means whereby every one of us young or old, rich or not-so-rich can help to fuel the war engine—and at the same time reap the rewards that come from systematic saving.

Report on Dominion-Provincial Relations

The Report of the Royal Commission on Dominion-Provincial Relations was made public at the time the June issue of THE CANADIAN CHARTERED ACCOUNTANT was going to press, and a reference to the principal recommendations contained in the report was published at pages 429-30 of that issue.[1]

The Report, which is the fruit of two and a half years of intensive work, is published in three volumes designated Books I, II and III and entitled respectively "Canada: 1867-1939," "Recommendations," and "Documentation," but "it should be fully understood," in the words of the Commissioners, "that all three Books are part of a single report which has been bound in separate volumes merely for convenience." This division is not, however, entirely arbitrary but reflects the circumstance that the terms of reference constituted the Commission both a fact-finding body and a body to make recommendations. Book I thus represents a "pooling" of the results of the Commission's research into the economic and social developments of the past seventy years; Book II contains the Commission's recommendations based upon the evidence submitted in public hearings and on the special research; while Book III consists of relevant statistical data and statistical statements illustrating in detail the financial proposals of Book II. Published together with the Report proper (but obtainable each one separately) are a number of appendices including finance statistics in detail of the Dominion and of each of the provinces and other special research studies which are

[1]The Report (three volumes, price $1.00), Appendices 1 to 8, and all the mimeographed studies (i.e., everything except the detailed Public Finance Appendices A to K) are available from the King's Printer, Ottawa, at an inclusive price of $10.00. The Public Finance Appendices are available at $5.00 each or $50.00 for the set. A copy of Books I, II and III has been sent by The Dominion Association of Chartered Accountants to the reference library of each provincial Institute.

of general interest and related to the Report but for which the Commission does not assume responsibility.

The Report touches very closely the welfare of every citizen of Canada, and all who are conscious of the privileges which they enjoy as members of a democratic community working out their own destiny will be impressed by a circumstance related at page 269 of Book II: "The Commissioners consider it both remarkable and significant that, on questions on which the most divergent views are widely and tenaciously held both by public men and by private citizens, they should have arrived at complete agreement. This agreement is not the result of compromise or of give and take but reflects a sincere unanimity of judgment in the great issues which confront the nation. Its significance is enhanced by the fact that the four Commissioners are men from different regions of Canada, men who differ widely in background and training, as well as in general outlook; and it is also significant that the conclusions which they have reached are far from being the views which any one of them held at the outset of the enquiry." If this is the experience of the Commissioners it is clearly the responsibility of every private citizen to approach as objectively as lies within his power the problems with which the Commission has grappled, to open his mind, as each Commissioner did, to the hard facts of economic and social change, and to defer final judgment on the proposals (taken not one by one in isolation but as an integrated whole) until sufficient time has elapsed for adequate digestion of their premises and import.

To public accountants as a professional body the Report is inevitably a matter of especial interest since the root problem with which it deals is the existing system of provincial subsidies, a problem whose solution inevitably involves re-allocation of taxing powers between the Dominion and provincial jurisdictions and one which, in its administrative aspects, is a matter peculiarly within the province of the profession.

Depreciation and Replacement Accounting

Depreciation problems in one respect are like the biblical poor; we seem to have them with us always. This appears to be the case especially in the public utility field where currently there

is some controversy over the question of replacement accounting as opposed to depreciation accounting. Professor Norman M. Hall, as consulting engineer for the Royal Commission on the Municipal Finances and Administration of the City of Winnipeg (1939), has apparently chosen sides in his submission quoted on page 227 of the Report of the Commission. He says: "The generally accepted definition of Depreciation is the consumption of property in service. It would therefore be a cost of operation occurring throughout the service life of the property; and not a cost to be incurred at the precise date of its replacement. Taking this as an adequate definition, there should be set aside annually from income such amounts as will create an accumulation that will provide for all replacements, when required, after crediting any net salvage value that may exist." The replacements here referred to are evidently not the replacements of the physical assets at whatever price may be current at the time of replacement but rather the replacements of values equal to the cost of the depreciating asset, for Professor Hall is careful to point out that when an asset is replaced by one costing a larger sum, an addition to capital assets is justified.

Service at Cost

Publicly-owned utilities are usually said to have as their prime objective the provisions of service at cost. The measurement of cost is not a simple process, in part because of lack of agreement as to the admissible elements. It is clear, however, that those public utility commissions or boards which include as costs both debt redemption charges and depreciation charges based on reasonable estimates of the economic life of the assets, and recover such charges from the consumer, are not providing service at cost but are in fact recovering more than cost, however defined. So long as this fact is recognized, the policy may possibly be considered justifiable in the light of other arguments. Those other arguments consist largely of the contention that the practice will eventually lead to lower consumers' rates than could otherwise be effected since interest on capital investments will be avoided. Present consumers, in other words, are asked to contribute the necessary capital so that they and succeeding consumers may receive the interest return in the form of lower costs, in the future.

The Royal Commission Report referred to above intimates that an interesting modification of this policy is being applied in at least one publicly owned utility in Canada, namely, the City of Winnipeg Hydro Electric System. The commission's consulting chartered accountant, after showing that in this enterprise depreciation is charged at a basic rate of three per cent per annum, pointed out that "since under the present policy all replacements and repairs are paid out of operating, the depreciation reserves will accumulate from year to year and, stated in terms of a percentage of the assets to be depreciated, will represent a constantly increasing percentage thereof."

Pay As You Go

The desire to avoid the flotation of loans to finance capital expenditures of public ventures is no doubt one aspect of the "pay-as-you-go" policy in public finance. Municipal government especially is now showing a growing tendency to favour the practice of paying for improvements out of revenue. The present time presents a favourable prospect in this respect for many Canadian cities. Local improvement and other debts incurred in the decade preceding 1930 were heavy, but are now maturing and are being retired. Relief costs, which in the early years of the depression were generally funded, are now being absorbed by many municipalities while the bonds previously issued for unemployment relief purposes are being redeemed. A "pay-as-you-go" policy means, of course, that tax rates, for a time, will be higher than would be the case if part of the expenditures were funded; that is the price which must be paid if municipal taxation is to be reduced eventually by the elimination of debt carrying charges. Such a policy will have effects on municipal finance which will be reflected by a considerable change in the appearance of municipal balance sheets, and the methods of presenting information, particularly in the capital section of the balance sheet, will merit serious attention.

DEPRECIATION ON APPRECIATION

The following is the full text of *Accounting Research Bulletin No. 5* issued in April 1940 by the Committee on Accounting Procedure of the American Institute of Accountants. It is published in THE CANADIAN CHARTERED ACCOUNTANT by the kind permission of the Institute.

Scope of This Statement

1. The committee has given extended consideration to the question of the proper accounting for depreciation on appreciation. The research staff has studied the available literature, and has caused several special memoranda to be prepared. The committee has discussed the subject at three of its meetings, and by correspondence.

As a result the committee now makes a definite recommendation with respect to the charge to be made against income in such cases, but has as yet developed no definite recommendations on other aspects of the problem. It has therefore been considered useful for the committee to issue this statement of its conclusion as to the proper charge against income, and to add thereto a discussion of other relevant questions. The latter discussion will, it is hoped, be helpful in furthering the formulation of conclusions on these other questions.

2. Accounting for fixed assets should normally be based on cost, and any attempt to make property accounts in general reflect current values is both impracticable and inexpedient. Appreciation normally should not be reflected on the books of account of corporations. The problem which the committee here considers is the treatment of charges against income where appreciation has in fact been entered on the books.

3. The word "depreciation" is here used in its ordinary accounting sense and not as the converse of "appreciation."

This discussion does not deal with cases in which the value of property may exceed the amount at which it is carried on the books because of increment due to lapse of time—such as the growth of timber, or to such causes as solidification or adaption—as of the roadbed of a railroad or a dam, or by reason of excessive allowance for depreciation in the past. On these cases no opinion is here expressed or implied. This bulletin is concerned primarily with appreciation due to (1) increases in the relevant price levels,

or (2) demonstration that the property has greater usefulness than is reflected in the amount at which it is carried in the books, as discussed later in paragraphs 11 and 12.

Conclusion as to Charge Against Income

4. The committee is of the opinion that when such appreciation has been entered in the books, income should be charged with depreciation computed on the new and higher values. This proposition is the most important part of the present statement and for it there seems to be general support. A corporation should not at the same time claim larger property values in its statement of assets, and provide for the amortization of only smaller property sums in its statement of income.

5. It is recognized that in the past the contrary view has been held in the profession and in other authoritative quarters, and in some cases it may be unreasonable to require a corporation to change a treatment adopted in good faith in the past. The committee believes, however, that a change to conform to the views now expressed is very desirable, and that members of the Institute should exercise their influence to the utmost to bring about such changes.

Discussion of Conclusion

6. From the strictly accounting point of view the depreciation charge against income is the element of primary importance. It should fairly reflect the consumption or expiration of property usefulness that has taken place.

The conclusion does not rest upon any basis of narrow logic or precise classification; it is derived from considerations of equity and public policy of the broadest character. These include an application of something analogous to the legal doctrine of estoppel, which asserts that one who has made certain representations is thereby precluded from afterwards averring anything inconsistent with them. In the present case this would mean that a company which has made representations as to an increased value of plant cannot afterwards account for depreciation and income as if it had never made such representations. When a company has made representations in its balance sheet as to an increased value of its property and others have bought its securities upon those representations, it is not unreasonable to interpret the formal adoption of the larger amount for plant as implying an intention on the part of the company

to maintain that larger amount of invested capital intact by proper charges against income. To implement such intention it is necessary that the company charge income with depreciation on the larger values represented.

7. If securities have been issued on the basis of a prospectus in which the higher values were claimed, there may be a legal, and there would certainly seem to be a moral, obligation to provide for depreciation of the property on the basis of these higher figures in arriving at the amount of profits available for distribution. Even if no prospectus has been issued, but the corporation has sought a market for its securities by listing them on an exchange, so that the new values have been shown in published annual reports, similar considerations may today be regarded as applicable. It may reasonably be argued that new purchasers of securities of the corporation are led to acquire them upon the understanding that the higher values already exist and have been given formal recognition, and therefore form a part of the values which they acquire by their purchase of the stock, and that consequently they may be misled if dividends are subsequently paid to them on the basis of earnings computed with depreciation charged on original cost.

Discussion of Other Aspects of the Problem

The following paragraphs deal largely with questions upon which, as stated above, the committee has as yet reached no conclusions. Most of these paragraphs do not represent opinions of the committee as a whole, but set forth the conflicting considerations which require careful study before more extended conclusions can be reached.

Accounting for Fixed Assets

8. The view expressed in paragraph 2 relates to accounts which form the basis for reports to stockholders and similar statements. Manifestly, there is no objection to showing estimated present values, nor to the computation of depreciation on that basis, for internal administrative purposes. A distinction can be made between the internal accounting for an enterprise and the accounting for the corporation which carries on the enterprise. From the standpoint of the enterprise, cost to the corporation is not of controlling significance, but, to the corporation itself, cost is the proper foundation of its accounting.

9. It must be recognized that in many cases appreciation has already been recorded on the books; it seems desirable, if practicable, to develop a standard procedure in such cases. In addition, instances occasionally arise in which appreciation is relatively so large and so well assured that it may be permissible from an accounting standpoint, and desirable upon more general grounds, to record it in the books. It should be added that in many cases the object sought could be better obtained by explanatory notes.

10. The cases of mines and industrial enterprises are not entirely analogous, but consideration of the problem of mine depletion furnishes an illustration which may be helpful in dealing with the more complex problem of an industry. It is of course recognized that mines are often not legally required to make, and do not make, depletion charges.

The capital value of a mine is, in theory, the sum on which the mine may be expected to yield a fair return after provision has been made for amortization of that capital value. The accounting basis will normally be cost, but where the present value of future income is very greatly in excess of the unamortized part of the cost of the mine to the corporation which owns it, a balance sheet of the corporation in which the properties are stated at cost may be less useful to the average investor than a balance sheet in which the properties are stated at a figure more nearly commensurate with existing values, and on which depletion is computed accordingly. In this, as in industrial cases, there is considerable question as to whether the situation cannot best be shown in the form of supplementary information not included in the accounts.

It has been suggested that one method of including the appraisal in the balance sheet with the least disturbance is to show the entire balance sheet on a cost basis, with totals, and then to add on the assets side the unamortized amount of the property appraisal increment, and on the liabilities side the corresponding appraisal credit.

11. Comparable cases arise in industrial practice only when an extreme inflation occurs, or when assets have been acquired at an abnormally low cost. It is not necessary here to discuss the former case; that might call for reconsideration of many practices followed in more normal times. It

may be useful, however, to examine the case of a property acquired at an abnormally low cost, the appropriate treatment of which turns to a considerable extent on the importance attached to different functions of accounts.

12. If in such case operations are charged with depreciation based on the low cost, the result will be to include in earnings from operations a profit which is in reality due to the exceptional character of the original purchase. It may be conceded that this profit is realized and available for dividends, but some hold the view that a clearer picture of the efficiency of the management will be presented if operations are charged with a provision for depreciation on a fair going concern value.

Treatment of Earned Surplus after Revaluation Entry

13. Some of those who feel it to be permissible or even necessary to charge operations with depreciation based on the higher appraisal value, would nevertheless like to have the final earned surplus reflect depreciation on original cost. These results might be attained by (1) charging operations with depreciation based on the revised book figure; (2) carrying to earned surplus as a separate credit the excess of the depreciation charged to operations over depreciation based on cost, with a corresponding charge to the revaluation credit account.

14. Assuming this view to be accepted, the questions would remain whether the credit last mentioned should reach earned surplus through income account or directly, and whether it should be deemed to be a part of the free earned surplus or should be regarded as appropriated earned surplus. If the arguments advanced in paragraph 6 are sound, so that a company which has written up its property values is deemed to be bound to charge income with the depreciation on the larger values represented, it is not proper to undo the effect of such a charge by making a transfer from the revaluation credit to income account. The conclusion reached in paragraph 4 requires that no such credit be made. Upon the same reasoning, even if the credit is conceded to form a part of earned surplus, it would seem that it should not form the basis of ordinary dividends, but should be regarded as appropriated surplus, or made the basis of dividends specifically described as to the source from which they are paid.

Treatment of Revaluation Credit Account

15. It was noted in paragraph 13 that some accountants favour regular periodic transfers from the appraisal credit to earned surplus, of amounts equal to depreciation on the appreciation recorded. Others argue that the appraisal credit should remain until disposed of by special action. Examples of such action would be: (1) transfer to capital stock by means of a stock dividend; (2) transfer to earned surplus, when appraised units are retired, of the amount of appraisal credit which has been realized with respect to such retired units; (3) lump-sum transfers to earned surplus, in amounts not exceeding the appraisal credit actually realized. Amounts transferred under (2) and (3) might perhaps be separately stated as a subdivision of earned surplus, appropriately described to indicate their source and nature.

16. When plant is stated at an increased value on the assets side of the balance sheet, should that increased amount of assets be regarded as implying an equivalent increase in "capital" as used in a restricted sense on the liabilities side of the balance sheet? Obviously it does not necessarily signify an increase in the legal stated capital; but some contend that it implies an increase in the unstated capital, in capital surplus in other words. To this it is sometimes added that capital surplus is just as much "capital" as capital stock—a proposition which is economically sound, but is subject to legal limitations which, since a corporation is the creation of law, the accountant cannot ignore.

17. Those who take this view say that the write-up has the effect of a quasi-reorganization—that it is an upward restatement of capital on the liabilities side, as well as of plant on the assets side. Accepting that view would mean that the credit item would be regarded as part of the capital structure, and not as available for transfer to earned surplus. Some go further and assert that an upward restatement of assets should not be entered in the books unless the management regards the situation in this light and is prepared to accept the consequences as stated. These consequences include, according to this view, not only the charging of income with depreciation on the larger amount—a point on which, as stated, there is general agreement—but also the "freezing" of the resultant credit item until it

is disposed of, if at all, into capital stock by means of a stock dividend.

18. Those who do not share the foregoing views find their point of departure in the nature of the representations made when the appraisal value is entered. They hold that the representation is merely of the present value of the plant, and not of the nature of the resulting credit item, at any rate not to the extent of classifying it definitely as capital. They regard the credit as a sort of suspense item, the true nature of which is to be determined by the future course of events, and to be assigned to earned surplus, or by stock dividend converted to capital stock, as circumstances may require. Others deny that the credit is a capital increase, and assert that it is merely an unusual profit, to be distinguished from ordinary operating profits.

Other Considerations

19. Certain other difficulties may be touched upon. It is not possible to make a general statement as to the legal standing of appraisal figures. This varies in different jurisdictions, and for different purposes. For example, appraisal figures usually have no recognition for income-tax purposes. However, there are exceptions, such as the March 1, 1913 values adopted as a starting point. Some state statutes recognize unrealized appreciation as a basis for asset values and for certain types of dividends. Regulatory commissions tend to favour cost as the basis of property accounting, but for other purposes consideration has frequently been given to appraisals, the degree depending on the circumstances of the particular case. The attitude of the S.E.C. on the question is not yet fully developed, its decisions in this area having involved chiefly the question whether a given appraisal was fair and reasonable.

20. The committee is not yet prepared to adopt any one of the foregoing viewpoints to the exclusion of the others. It may be that varying circumstances will in any case require that alternative treatments be available. The committee hopes to return to this subject at a later date when further discussion and experience have clarified the issues.

21. Appendices A and B give some factual information with respect to the problems discussed in this paper.

Appendix A contains data concerning the balance-sheet treatment of property items, based on a study of 500 balance sheets for 1938.

Appendix B quotes from a published source some figures showing (a) the amounts of write-ups and write-downs for a ten-year period, and (b) the number of corporations making such write-ups or write-downs, both based on a study of 272 corporations.

APPENDIX A

Practice with Respect to Carrying Values of Fixed Assets and Statement of Capital Surplus or Equivalent Items

A study of 500 published balance sheets for 1938 shows:

On assets side	
Of the 500 balance sheets, 480 contained one or more property items to the number of	562
Of these 562 property items:	
Number described as at cost, at cost less reserves, or acquisition values	251
Number described as appraised or revised values—in various forms	135
Other captions (most frequent being "book values"—33)	75
No basis of valuation indicated	101
Total property items	562
On liabilities side	
Of the 500 balance sheets, 321 contained items of capital surplus or equivalent items to the number of	332
Of these 332 items of capital surplus:	
Number described as "capital surplus"	239
Number described as "paid-in surplus" or equivalent terms	57
Number described as arising from revaluation or appraisal	10
Number described as acquisition surplus, conversion surplus, etc.	26
Total capital surplus or equivalent items	332

APPENDIX B

The following tables have been taken from *Capital Consumption and Adjustment,* by Solomon Fabricant, a publication of the national Bureau of Economic Research. They furnish some conception of the extent of write-ups and write-downs.

Write-ups and Write-downs of Property, Plant and Equipment 1925-1934[1]

272 Large Industrial Corporations (Unit: $1,000)

	Write-ups	Write-downs	Net write-ups
1925	28,309	12,813	15,496
1926	65,944	24,356	41,588
1927	23,248	16,432	6,816
1928	26,255	68,429	—42,174
1929	14,359	128,578 [2]	—114,219
1930	24,392	16,723	7,669
1931	5,924	194,686	—188,762
1932	23	251,468	—251,445
1933	123	117,315	—117,192
1934	77	117,426	—117,349

Corporations reporting Revaluations of Property, Plant and Equipment, Number, 1925-1934[3]

	Total [4]	
	Write-ups	Write-downs
1925	12	10
1926	13	13
1927	14	11
1928	16	16
1929	12	15
1930	8	23
1931	4	48
1932	1	55
1933	2	44
1934	1	27

[1]Table 43 (page 213).
[2]Including 113 millions for United States Steel Corporation.
[3]Table 45 (page 215).
[4]Out of 272 corporations examined.

The statement entitled "Depreciation on Appreciation" was adopted by the assenting votes of eighteen members of the committee. Four members, Messrs. Blough, Couchman, Fernald and Paton dissented.

The grounds for dissent were varied. Without giving a full discussion of these, the main points may be stated. Mr. Blough dissented with respect to paragraph 5; in his opinion the rule in paragraph 4 should be applied at once in all cases. Mr. Couchman dissented on the ground that he would prefer to return more strictly to the cost basis, rather than allow further departures therefrom. In cases where appreciation has been entered in the books, he would prefer that the appraisal credit be deducted from the appraised value in the balance sheet, thus restoring it to a cost basis. Mr. Fernald dissented as to the legal implications of paragraphs 6 and 7, considering that financial statements do not constitute any representation or commitment that invested capital will be maintained intact or dividend payments will be limited except only as applicable law may from time to time prescribe. Mr. Paton does not approve of any departure from the cost basis for depreciation charged in determining the final net income figure reported, except in cases where the appraisal is a feature of a formal or quasi-reorganization.

Mr. Fedde assented to the paper with the proviso that depreciation based on appreciated property values be charged in two amounts, (1) depreciation on cost, and (2) depreciation on appreciation.

Notes

1. Accounting Research Bulletins represent the considered opinion of at least two-thirds of the members of the committee on accounting procedure, reached on a formal vote after examination of the subject matter by the committee and the research department. Except in cases in which formal adoption by the Institute membership has been asked and secured, the authority of the bulletins rests upon the general acceptability of opinions so reached. (See Report of Committee on Accounting Procedure to Council, dated September 18, 1939.)

2. Recommendations of the committee are not intended to be retroactive, nor applicable to immaterial items. (See Bulletin No. 1, page 3.)

3. It is recognized also that any general rules may be subject to exception; it is felt, however, that the burden of justifying departure from accepted procedures must be assumed by those who adopt other treatment. (See Bulletin No. 1, page 3.)

Committee on Accounting Procedure

John K. Mathieson, Chairman
George O. May, Vice-Chairman
George D. Bailey
Carman G. Blough
Archibald Bowman
Arthur H. Carter
Clem W. Collins
Charles B. Couchman
William D. Cranstoun
A. S. Fedde
Henry B. Fernald
Stanley G. H. Fitch
Henry A. Horne
Lincoln G. Kelly
Roy B. Kester
Lewis Lilly
A. C. Littleton
Warren W. Nissley
William A. Paton
Charles F. Rittenhouse
Walter A. Staub
Victor H. Stempf

John L. Carey, Secretary

(See page 19 for text of *Accounting Research Bulletin No. 6.*)

COMPARATIVE STATEMENTS

The following is the full text of *Accounting Research Bulletin No. 6* issued in April 1940 by the Committee on Accounting Procedure of the American Institute of Accountants. It is published in THE CANADIAN CHARTERED ACCOUNTANT by the kind permission of the Institute.

Extension of Use Recommended

THE increasing use of comparative statements in the annual reports of companies is a step in the right direction. The practice enhances the significance of the reports, and brings out more clearly the nature and trends of current changes affecting the enterprise. The use of statements in comparative form serves to increase the readers' grasp of the fact that the statements for a series of periods are far more significant than those for a single period—that the statements for one year are but one instalment of what is essentially a continuous history.

It is therefore recommended that the use of comparative statements be extended. In any one year it is ordinarily desirable that the balance sheet, the income statement and the surplus statement (the two latter being separate or combined) be given for the preceding as well as for the current year. Footnotes, explanations and accountants' qualifications already made on the statements for the preceding year should be given, or at least referred to, in the comparative statements. If, because of reclassifications or for other reasons, changes have occurred in the basis for presenting corresponding items for the two periods, information should be furnished which will explain the change. This is in conformity with the well recognized rule that any change in practice which would affect comparability should be disclosed.

The question of responsibility to be assumed by the accountant in his report requires consideration. In general it is desirable that he should accept the responsibility of satisfying himself that the figures for the preceding year fairly present the position and results, and are properly comparable with those of the current year, or that any exceptions to their comparability are clearly brought out. In the common case in which the accountant will have examined the accounts of both years no difficulty in assuming this responsibility should arise.

Circumstances vary so greatly that it is not practicable to deal here specifically with all cases. The accountant should, however, make very clear what statements are included in the scope of his report and any reservations which he may have in regard to accounts not so included.

The statement entitled "Comparative Statements" was unanimously adopted by the twenty-two members of the committee.

Mr. Henry B. Fernald assents to this statement but with some reservation regarding comparative income accounts. He feels that sometimes they may be misunderstood unless accompanied by adequate explanations, and that too much importance must not be attached to a showing of income differences from one year to the next.

Notes

1. Accounting Research Bulletins represent the considered opinion of at least two-thirds of the members of the committee on accounting procedure, reached on a formal vote after examination of the subject matter by the committee and the research department. Except in cases in which formal adoption by the Institute membership has been asked and secured, the authority of the bulletins rests upon the general acceptability of opinions so reached. (See Report of Committee on Accounting Procedure to Council, dated September 18, 1939.)

2. Recommendations of the committee are not intended to be retroactive, nor applicable to immaterial items. (See Bulletin No. 1, page 3.)

3. It is recognized also that any general rules may be subject to exception; it is felt, however, that the burden of justifying departure from accepted procedures must be assumed by those who adopt other treatment. (See Bulletin No. 1, page 3.)

Committee on Accounting Procedure

John K. Mathieson, Chairman
George O. May, Vice-Chairman
George D. Bailey
Carman G. Blough
Archibald Bowman
Henry A. Horne
Lincoln G. Kelly
Roy B. Kester
Lewis Lilly
A. C. Littleton

Arthur H. Carter
Clem W. Collins
Charles B. Couchman
William D. Cranstoun
A. S. Fedde
Henry B. Fernald
Stanley G. H. Fitch
Warren W. Nissley
William A. Paton
Charles F. Rittenhouse
Walter A. Staub
Victor H. Stempf

John L. Carey, Secretary

AN OUTLINE OF THE ORGANIZATION AND ADMINISTRATION OF BRITISH COLUMBIA MUNICIPALITIES

By V. Randolph Clerihue, Chartered Accountant
Vancouver, British Columbia

THE following article on the organization of British Columbia municipalities and some of their major financial aspects is written with the hope that it may be of interest as a comparative outline for those familiar with municipal administration in the other provinces of Canada. To the British Columbian reader, it must depend upon its value as a preliminary survey or as a "refresher" summary of the subject.

Municipalities in British Columbia are of three classes: cities, districts and villages. A city municipality is any urban municipality, other than a village municipality, and, subject to the available alternatives described below, is governed by a mayor and council. The members of the council are called aldermen. The *Municipalities Incorporation Act* specifies that the area to be incorporated as a city must not exceed two thousand acres and contain at least one hundred male residents being British subjects of the full age of twenty-one years. In the latest report of the provincial Department of Municipal Affairs it appears that six of the thirty-two cities, other than Vancouver, have areas in excess of two thousand acres. In that group of six the largest in area is six thousand two hundred acres but has a population of only sixteen hundred. There presumably are historic explanations for these exceptional cases but the writer is not familiar with them.

A district municipality is a rural or suburban district and is governed by a reeve and council. The members of the council are called councillors. No area limit is specified

for a district municipality and the population minimum for incorporation is designated as thirty male British subjects of the full age of twenty-one years.

As an alternative form of municipal administration the *Municipal Act* provides for a board of control. For this purpose a by-law of the council, to be passed by a two-thirds majority of its members, shall declare that the business of the municipality, from the commencement of the next ensuing year, be managed by a board of control composed of the mayor, or reeve, of the municipality and two controllers to be nominated and elected from the municipality at large, the said controllers to be members of the council for all purposes. This provision is to apply to municipalities having populations of fifteen thousand or more. The board of control in such circumstances is the executive body of the municipality, engaging and dismissing heads of departments, awarding contracts, preparing the budgets and making recommendations to the council for its action.

There is also a *Municipal Manager Act* which provides that the council of any municipality may appoint an official to whom may be delegated any of the powers given to a municipal council by any statute. So far as the writer is aware, neither of these two latter plans of administration has been adopted by a British Columbia municipality.

A village municipality is governed by a board of commissioners, three in number, which elects its own chairman. Except for domestic water service and sewers, if deemed essential for health purposes, villages are denied power to incur liability beyond the amount of their revenue for the current year. It may borrow up to only seventy-five per cent of its revenue for any year. Village municipalities have no responsibility, financial or otherwise, for education or the administration of justice within their areas, as these services are administered by the provincial government. All powers and restrictions of villages are covered by the *Village Municipalities Act,* with the exception that this act cites certain provisions of the *Municipal Act* and the *Poll Tax Act* as being applicable to villages.

The City of Vancouver has its own charter and therefore does not come under the provisions of the *Municipal Act.* In British Columbia its position is thus unique.

The first British Columbia *Municipal Act* was passed in

the year 1872. However, two cities in the province had been incorporated prior to that date, namely, New Westminster in 1860 and Victoria in 1862.

According to the latest report of the Department of Municipal Affairs, the following particulars appear concerning British Columbia municipalities (including Vancouver):

	Number of Municipalities	*Estimated Population*	*Total Area in Acres*
Cities	33	422,750	73,826
Districts ...	28	141,300	906,753
Villages	19	8,400	6,896
Totals	80	572,450	987,475

The population of the Province of British Columbia is approximately 740,000 persons, of which seventy-seven per cent live in incorporated municipalities. The respective populations of the three largest British Columbia cities follow:

Vancouver	270,000
Victoria	39,000
New Westminster	20,500

The three largest district municipalities, in point of population, are respectively:

Burnaby—Contiguous to Vancouver	26,000
Saanich—Contiguous to Victoria	12,500
Surrey—Across the Fraser River from New Westminster	11,400

Governing Legislation

With the exception of the City of Vancouver, all municipal corporations in British Columbia are governed chiefly by the *Municipal Act* (for city and district municipalities) and the *Village Municipalities Act* (for villages only); but there is also a considerable volume of complementary legislation affecting municipal administration, most of which has some bearing on the finances of the municipalities either directly or indirectly. Such complementary legislation includes a number of Acts on the subjects of local improvements, municipal aid, public schools, poll tax, municipal elections,

teachers' pensions, public libraries, hospitals, health, cemeteries and fire department hours of labour. In addition to these there exist a number of private acts affecting approximately two-thirds of the cities and half of the districts, but apparently none of the villages. Many of these private acts relate to financial matters of the municipalities and are of moment to the municipal auditor for the bearing they may have upon the respective municipalities. It should be mentioned, also, that in the *Municipal Act* there are sections relating to specific municipalities. The cities of New Westminster and Victoria are the subjects of the greater part of these specific regulations.

Officials

The officials of British Columbia municipalities, obligatory by the *Municipal Act*, are the clerk of the council, the treasurer, the assessor, the collector and the auditor. Except that of the auditor, two or more offices may be held by one person.

Specific sections of the *Municipal Act* state that the Council of every municipality shall appoint one or more auditors and an assessor and collector. While the appointment of clerk or treasurer is not similarly indicated, their appointments would appear to be obligatory by inference. For instance the following appears: "The Clerk (57), Treasurer (386) of every municipality, etc." Provision is made empowering the council to make appointments of officers as may be deemed necessary or expedient for the carrying on of good government of the municipality.

Assessment

The British Columbia *Municipal Act* uses the term "assess" according to the following meaning of the word: "To estimate officially the value of property or income for taxation." Thus the assessor in a British Columbia municipality values the land and improvements for the purpose of determining the basis of taxation. Such valuation, according to the *Municipal Act*, is described in abridged form as follows:

"Land . . . at its actual value, and improvements . . . at the amount of the difference between the actual value of the whole property and the actual value of the land if there were no improvements; provided, however, that land

and improvements shall be assessed separately." Land may be classed as "wild" or otherwise. Wild land is that upon which improvements are of less value than ten dollars an acre. What appears as an anomaly is that railway and tram tracks, telephone, telegraph and electric pole lines and cables, gas mains, dams, ditches, flumes and pipe lines of irrigation companies are assessed as land. The values at which these are to be assessed are fixed by statute.

Certain lands and improvements are exempt from taxation, such as those owned and actually used as churches, hospitals, orphanages and cemeteries. Crown and municipal lands and improvements are also exempt except when under lease or agreement for sale or otherwise alienated.

Assessment Roll

The *Municipal Act* requires that "The assessor of every municipality shall in every year prepare an assessment roll, in which he shall set down with respect to each and every parcel of land within the municipality:

Legal description

Extent or area thereof

Value thereof

Classification of land as to wild or otherwise

Value of all improvements thereon

Name or names and addresses of registered owner thereof, or agreement holder or occupier

Names and addresses of persons claiming notice of assessment (e.g. mortgagee)

The names of any persons interested in assessable land the fee-simple of which is held by the Crown

Particulars of feet or miles of railway and tram tracks, telephone, telegraph and electric pole lines and cables, gas mains, irrigation dams, ditches, flumes and pipe lines

The number of days' statute labour (if any) for which each person is considered liable." (So far as one can learn, statute labour is now obsolete and in any case does not apply where road tax is levied.)

Before the assessor "returns" the assessment roll to the municipal clerk, he shall, with respect to each parcel of land, transmit by post to the person or persons named on such assessment roll as owner or entitled to notice, a notice showing the description, classification and assessed value of land, the assessed value of improvements and the date of the

first session of the court of revision for the consideration of the assessment roll.

The council of any municipality, if it thinks fit, by resolution may adopt the assessment roll of the previous year, subject to incidental changes such as those of ownership, increases or destruction of improvements.

The assessor shall, in each year, "return" his roll to the clerk of the municipality not later than the thirty-first day of December, together with a statutory declaration that to the best of his judgment and ability the values therein are in accordance with the requirements of the *Municipal Act*.

The assessment roll then is dealt with by a court of revision consisting of the municipal council or five members thereof appointed for the purpose at the first meeting of the council. The court of revision hears any complaints against the assessments made and may alter or confirm the assessments but cannot increase them without giving notice of its intention. When this court has dealt with all complaints and has made the necessary alterations, the roll is signed by the members of the court. Appeals from the decisions of the court of revision may be made to a judge of the Supreme Court of British Columbia or a county court judge having jurisdiction in the municipality.

Tax Levy

When the assessment roll has been confirmed, the council then sets the tax rate for the year. This is done by a by-law which shall be passed by the council on or before the fifteenth day of May in each year. The tax rate by-law shall show the rates severally levied to provide for interest on and retirement of the bonded indebtedness, other than that incurred for the school board; the amount required for school purposes according to the estimates submitted by the school board; for interest on and retirement of bonded indebtedness incurred for schools; and for all other lawful purposes of the municipality. For this last purpose, i.e., "general purposes," the rate must not exceed thirty-five mills. Until legislation of 1932, this was limited to twenty mills but, presumably due to the exigencies of the recent economic depression with the consequent added cost of direct and indirect relief, the smaller tax rate limit was found inadequate.

Land is taxed on one hundred per cent of its assessed

value with the restriction that land classified as "wild" is limited to a tax rate of fifty mills on the dollar of valuation.

Improvements in cities and districts may not be taxed on more than seventy-five per cent of their assessed value; and in villages, fifty per cent. To indicate the present practice in this regard, the following table for the year 1939 is given:

Per cent of assessed value of improvements taxed	*Number of Municipalities*		
	Cities	*Districts*	*Villages*
From 51 per cent to 75 per cent inclusive	2	1	—
From 26 per cent to 50 per cent inclusive	23	16	19
From 1 per cent to 25 per cent inclusive	6	7	—
Exempt from taxation	2	4	—
Totals	33	28	19

With the assessment confirmed and the tax rate determined for the year, the treasurer's department then calculates the amount of taxes for each parcel of property and enters them in the debit column in the tax roll against the respective parcels. As proof of the total thus produced, a calculation is made on the total taxable assessment. It will be found that a number of adjustments may be necessary for fractional differences, some of which arise from the fact that the minimum tax on any parcel is one dollar, unless the council, by by-law, determines some lesser minimum. A schedule should be prepared to support the tax levy journal entry, showing such adjustments page by page of the tax roll. In other words, a reconciliation should be prepared between the total tax revenue, as calculated on the total taxable assessment and the total as entered on the tax roll. Using the total entered on the tax roll, the controlling journal entry will be set up.

Penalties

As an inducement to prompt tax payments, the *Municipal Act* provides that a penalty addition to unpaid taxes be made on 1st July in the current year. This penalty, by by-law of the council, may be spread over the year so that the total penalty of ten per cent is added to the unpaid current taxes by 31st December. Penalties so added form part of the current revenue and should be journalized on the date or dates imposed by the by-law. Collection of penalties should be recorded separately from current taxes,

as such information is necessary for the financial statements.

Interest on Taxes in Arrears and Delinquent

Another form of revenue in connection with taxes is interest on tax arrears.* This is charged at six per cent per annum from the first of the year in which the taxes fall into arrears to date of payment. At the end of each year, interest on arrears if then unpaid is consolidated with the tax and carried to the succeeding year's roll as delinquent taxes. Interest accrues thereon at six per cent per annum until paid or the property is put up for sale.

Tax Sale

Within the month of September in each year, the municipal collector shall offer for sale by public auction all and every parcel of land with any improvements thereon (except that owned by the Crown) upon which the taxes thereon are "delinquent." No notice or advertisement of the sale is required by law, but the council may make such advertisement as it may see fit. The collector acts as auctioneer at such sale. The upset price of each parcel, for the purpose of the auction, shall be the total of the following:

Delinquent taxes,
Tax arrears,
Interest thereon to date of sale,
Current taxes,
Penalties levied to date of sale,

An amount of five per cent of the total of the foregoing —which, being revenue, is credited to an account usually called "tax sale revenue"—and such sum as may be necessary to pay land registry charges—seventy-five cents for notice of the parcel going to tax sale; seventy-five cents for notice of redemption; and five dollars for tax sale deed.

If at least the upset price of each parcel is not bid at the auction, the respective properties fall to the municipality, subject to redemption within the succeeding year. Within nine months after the tax sale, any property falling to the

*Taxes in "arrears" are taxes levied, say, in 1938 and still unpaid in 1939. "Delinquent" taxes are those levied in 1937 and still unpaid in 1939. Tax "arrears" is the commonly used term for both arrears and delinquent unless, for any purpose, the distinction is essential. Likewise "interest on arrears" is the commonly used term for interest on both arrears and delinquent taxes.

municipality, by resolution of the council, may be sold at its upset tax sale price plus interest at six per cent per annum from the date of the tax sale. A purchase thus made is of the same status as if made at the tax sale, i.e., subject to redemption by the assessed owner.

The journal entry removing taxes from the tax roll is based upon the elements stated below. This entry assembles and controls all values in the tax sale during the period allowed for redemption:

(Year) Tax sale property (upset value)

Delinquent taxes
Tax arrears
These are frequently held together in one controlling account in the general ledger.

Interest on arrears
Taxes receivable (current year)
Penalties receivable (current year)
Tax sale revenue (year)
Tax sale costs payable.

As a passing observation on municipal tax sales in British Columbia, it may be stated that the total upset value of property sold for taxes in 1938 was approximately $480,000.00 of which 78.4 per cent fell to the municipalities. Properties acquired through tax sales by all British Columbia municipalities by the end of 1938 had an upset value of something in excess of sixteen million dollars.

Property falling to a municipality at tax sale, and which is not redeemed within the period allowed therefor, becomes the property of the municipality and is transferred from the tax sale register to an account that may be termed "corporation property." The several parcels thereof are recorded in separate accounts in a subsidiary ledger and controlled by the relative account in the general ledger. Thereafter, corporation property may be sold by the council either for cash or upon terms under an agreement for sale.

Other Sources of Revenue

The usual sources of municipal revenue in British Columbia, other than taxes on real estate, are the following: Trade licenses; police court fines; poll tax; road tax; dog tax; school tuition fees (chiefly from extra-municipal high school pupils); scavenging charges; permits for building, plumbing and electric wiring; bank interest; sundry other

minor sources; public utilities; and provincial government grants from motor vehicle taxes, for schools (teachers' salaries) and for direct relief (during approximately the last decade).

Revenue from public utilities stands next to taxes on real estate in gross total for British Columbia municipalities. These utilities include waterworks, electric light, telephones, street railways, ferries, gas and irrigation, while some municipalities have revenue from franchises to privately owned utilities.

The foregoing list includes revenue that is levied or received for the school board, such as grants for schools, school tuition fees and poll tax. (Poll tax is to be used for maintaining and granting aid to schools and hospitals). In British Columbia there would seem to be some difference of opinion as to how school revenue, and the receipt thereof, should be shown on the financial statements of the municipality which levies and collects it. Some municipalities show all revenue as municipal revenue, including revenue for schools and, conversely, show school expenditure as municipal expenditure. Other municipalities exclude school revenue and expenditure from the municipal revenue and expenditure statement but, in most cases, the school cash receipts and disbursements are included in the municipality's statement of cash receipts and disbursements.

The reason school revenue and expenditure receives special treatment is doubtless due to the fact that the British Columbia *Public Schools Act* requires that the treasurer of each municipality shall set apart and keep in "Board of school trustees account" all moneys levied or received for school purposes, and any balance unexpended at the end of the year shall be carried over and appear at the credit of the school board for ordinary purposes. The writer is not sure that such a provision as the foregoing is full justification for excluding school board revenue and expenditure from the municipal revenue and expenditure statement when, for more important reasons than mere convention, the school board's assets and liabilities invariably appear on the municipality's balance sheet.

Debenture Debt

Municipalities in British Columbia, other than villages, may raise money for public works by the issue of debenture

bonds. The procedure necessary to authorize such a bond issue, in brief, is as follows:

When a capital expenditure is contemplated out of a bond issue and the cost has been ascertained, the proposal in the form of a by-law is submitted to the provincial Department of Municipal Affairs where it is examined in the light of the municipality's needs and its consequent financial position. This department of the government, it may be added, was established only in 1934 with its Minister and Deputy Minister; prior thereto, the functions of the department were carried out by an inspector of municipalities under the attorney-general of the province.

If approved by the department, the by-law is then submitted to the ratepayers for their approval, which shall be indicated by a three-fifths majority. While trade-licence holders and municipal residents who qualify as "householders" may vote for the elected municipal officials, only owners of land may vote on "money" by-laws. The reason for this is that the land and improvements within the municipality are pledged for the repayment of the debt. The by-law shall be advertised at least ten days before the poll is taken. If the by-law carries, a period of one month is provided in which interested parties may apply to the Supreme Court of British Columbia to quash it. If within the month no such action is brought, or if it is brought and fails, the bonds then can be printed. They are signed by the mayor or reeve, as the case may be, and the treasurer of the municipality, and sent to the Inspector of Municipalities for endorsing his approval. Thereafter the bonds are not open to question on any grounds whatever in any court in the province of British Columbia.

The proceeds of a sale of bonds shall be kept in a separate bank account and expended only for the purpose for which they were raised.

The limit of borrowing power of a British Columbia municipality is twenty per cent of the sum of the assessed value of land and improvements within the municipality plus the depreciated value of the municipality's public utility assets.

The majority of British Columbia municipal bonds are repayable by the sinking fund method, though latterly the provincial Department of Municipal Affairs has been strongly advising the adoption of instalment or serial bonds.

Financial Statements

The British Columbia *Municipal Act* requires that the financial report on a municipality shall comprise a balance sheet as at 31st December in each year, a statement of cash receipts and disbursements, and a statement of revenue and expenditure for the year then ended. These shall be signed by the municipal treasurer and certified by the auditor. Together with the auditor's report, these shall be printed in pamphlet form for the information of the ratepayers. The City of Vancouver, not being governed by the *Municipal Act*, prepares no statement of cash receipts and disbursements.

Some experience with municipal administration causes the writer to doubt whether the value of the cash statement, required of a British Columbia municipality, is commensurate with the labour of maintaining the records necessary for its preparation. This statement seems to be the source of more confusion than clarification to many ratepayers. Possibly the greatest use made of the statement of cash receipts and disbursements is by the provincial Department of Municipal Affairs, whose annual reports, apart from giving tabulations of real estate taxes levied, show all operating data on the basis of cash receipts and disbursements. In passing it may be pertinent to observe that in recent years the reports of this department have shown a marked improvement in both content and presentation from the standpoint of the information given to the public.

This outline has not attempted to be exhaustive of the subject undertaken. The article is presented with the hope that it may initiate a series of similar outlines of municipal affairs in other provinces. Such a series it is believed might prove to be of some importance in the study of municipal affairs in Canada.

ACCOUNTANTS AND THE LAW OF NEGLIGENCE

By W. Summerfield and F. B. Reynolds
London, England

Editor's Note—This series of articles on a subject of wide interest to accountants, written by W. Summerfield, M.A., B.C.L., LL.B., and F. B. Reynolds, A.C.I.B.—authorities in the fields of law and insurance respectively—and appearing in *The Accountant* (London), is published with the kind permission of the Editor of that magazine.

(Continued from June issue)

Accountancy or Auditing?

A detailed consideration of the distinctions between the functions of an accountant and those of an auditor was provided by the case of *The Trustee of the Property of Apfel (a bankrupt)* v. *Annan, Dexter & Co. (The Accountant,* 18th December, 1926.)

The trustee sought by this action to recover the sum of £28,601 from the defendants, as damages for alleged negligence and breach of duty as accountants and auditors.

From May, 1922, down to the commencement of her bankruptcy, the bankrupt had carried on business as a skin and fur merchant, employing her two sons as salaried managers, she herself taking no active part in the conduct of the business.

The plaintiff alleged that Mrs. Apfel (the bankrupt) had employed the defendants to audit the accounts for the period (eight months) ending 31st December, 1922, and for the year ending 31st December, 1923, and that they had signed a balance sheet in respect of each of those periods; and that during those periods her two sons, who were authorized to draw on her banking account for the purposes of the business, had, in fact, drawn sums which they had converted to their own use, amounting to £9,633. Thereafter, until the bankruptcy they drew further sums, similarly, totalling £30,898.

In June, 1925, the bankrupt executed a deed of assignment to a partner in the defendant firm as trustee for the benefit of her creditors, and at a meeting of her creditors a statement of affairs, prepared by the defendants, showed a deficiency of £30,537, about 80 per cent of which sum (according to the plaintiff) represented sums converted by the sons.

In February, 1926, both the bankrupt's sons had been

charged (at the Central Criminal Court) with fraudulent conversion in respect of the management of their mother's business; one of them, having pleaded guilty, was sentenced to fifteen months' imprisonment, whilst the other had pleaded not guilty, and was discharged, and had since died.

The particulars of negligence and breach of contract alleged were that the defendants knew that the sums drawn by the sons were in excess of the amounts which (a) they were properly entitled to draw, and (b) which the business could stand — or that the defendants ought to have so known. Further that the defendants knew that the said sums had been converted by the sons to their own uses — or that they ought to have so known if they had vouched the cash payments of the business properly or at all. Further, that the defendants knew that the sons had, by book entries, credited themselves with bonuses on profits in sums of £2,500 each for the audit periods, and had purported thereby to conceal the amounts of their said drawings; that the defendants had passed those book entries with full knowledge of the facts, including the fact that the business was being conducted on borrowed capital and had made no profits from which any bonuses at all could be paid. The bonuses, it was alleged, were not disclosed in the profit and loss accounts or in the balance sheets which the defendants had prepared and passed, and the balance of the indebtedness of the sons to the bankrupt (after crediting the bonuses) was (a) shown in the balance sheets as an ordinary book debt, and (b) taken at its face value—notwithstanding that the defendants knew, or by proper enquiry could have known, that the sons were insolvent. Further, that the defendants, although aware that the bankrupt knew little or nothing of business matters and that she relied on their diligence as accountants and auditors, never gave her proper information as to either (a) the true position of her business, or (b) its conduct by her sons as managers. It was alleged that the balance sheets and profit and loss accounts as prepared and passed by the defendants were misleading in that they concealed, or failed to disclose, the above matters as alleged, and in that they showed that the business of the bankrupt was being conducted properly, and was solvent, and was being carried on at a profit. Furthermore, that if the defendants had searched the entries in the cash book and

ledger of the business they would have discovered the sons' misappropriations. The sum claimed by the plaintiff from the defendants, viz. £28,601, was the balance arrived at after deducting the sum of £2,297 which had been drawn from the business prior to the audit period from the total sums converted namely, £30,898.

The evidence showed that the bankrupt, upon the death of her husband in May, 1922, had succeeded to a business which had been carried on by her husband and two sons in partnership. The business was then insolvent, the deficiency being in the region of £200,000. A deed of assignment for the benefit of the creditors (of the old business) had been executed by the sons as surviving partners; and the creditors accepted a composition of 3s. in the pound; the two sons, furthermore, being also insolvent, had executed deeds of assignment on their own behalf, to a partner in the defendant firm, for the payment of their private debts, and their creditors, too, had accepted a composition. The bankrupt had borrowed about £8,000 for the purpose of continuing the business which, although in law it was to be regarded as a new business (her own business), was, so to speak, charged with the payment of the agreed composition to the creditors of the old business.

The first issue to be determined, said Mr. Justice Astbury, was: in what capacity had the defendants been employed? Was it as auditors (as the plaintiff alleged), or (as the defendants contended) as accountants to prepare on behalf of the bankrupt the accounts necessary for the purpose of filling in her income-tax returns.

It appeared from correspondence between the defendants and the Inspector of Taxes that they had, in fact, been instructed to prepare the income-tax returns, and that in order to execute that retainer they had had a great deal of work to do on the books of the business, which were badly kept. The bankrupt had been debited for preparation of accounts and the auditing of her books. Nevertheless, the defendants still contended that their retainer was merely as accountants to prepare income-tax returns, although, in order to prepare such returns they had to do a great deal of work in making up the books.

If, in fact, proceeded the learned Judge, the retainer

had been merely to prepare taxation returns, the defendants could not be held responsible for the correctness or otherwise of the entries in the books; their responsibility was confined to ascertaining the position of the business as shown by the books, when made up as well as might be from their actual condition. That was the work of an accountant, and the work which they appeared from the certificate which they had given to have undertaken. If, however, they had undertaken the duty of auditors they would have been required to (a) make up the books properly, (b) get out such accounts as the books appeared to show, and (c) ascertain the true position of the business, whether the books properly disclosed it or not.

Although the fee note rendered by the defendants to the bankrupt had been phrased: "to professional services rendered in the preparation and auditing of your accounts," the debit as entered in their own books read: "fee for services in connection with the adjustment of income-tax liability as indicated in letter—100 guineas." This fee was held to be reasonable having regard to the special accountancy work which had been necessary, i.e. an inference that it was more appropriate for an audit could not be drawn.

This case affords, then, an excellent illustration of the propositions (a) the amount of the fee charged is no sure indication as to whether the accountant was retained for accountancy or audit work; (b) not even the way in which the accountant may himself describe his work is conclusive; (c) the risk which may accrue to a principal through the error of his assistant is always substantial—for here the fee-note rendered, which put grave difficulty in the way of the defence, seems to have been drawn by a clerk who acted either carelessly, or without a clear notion in his own mind as to the distinction to be drawn between accountancy and auditing, or without knowledge of the nature of the work undertaken by his firm for this client.

This case should serve to emphasize, furthermore, how (disproportionately) high the risk of negligence in law may be. For work for which his fee was 100 guineas might have resulted in the accountant having to pay £28,601 *plus* costs. There is, of course, no direct relation between size of risk and size of fee in professional practice.

(To be continued)

THE EMPIRE'S HOME FRONT

Editor's Note: The following are extracts from an address to the Life Institute of Canada, given by J. M. Macdonnell, President and General Manager of the National Trust Company.

Everything must now be subordinated to one great task. It would be indecent to be pursuing our own selfish ends when so many of our fellow-citizens in the armed forces of the Empire are putting everything to the hazard of fate. Our national future—and indeed whatever makes life worth living to us—is now called in question. The only way to settle this question is by victory.

You, like myself, are finding it hard to take the same satisfaction out of your work as formerly. You cannot help wishing you could do direct war work, and you have got to convince yourselves that you are playing your part.

We must try to get a clear picture of the part played by the economic organization of an industrialized nation in wartime. When a primitive nation goes to war the problem is quite simple. In totalitarian States like Germany, the change-over, though not so simple, is as immediate and complete as the lives of the citizens can make it. In democratic countries, the change-over can proceed only so fast and far as the sentiment of the people will tolerate it. In Britain, the extent already contemplated is prodigious. The first great change-over is in the field of arms and munition work. When the Expeditionary Force landed in France in 1914, there were 800 motor vehicles of approximately two tons weight each. When the Expeditionary Force landed in 1939, with approximately the same number of men, there were 25,000 motor vehicles of several times greater average weight. This gives an indication of the machine nature of the war, and serves to indicate the importance of the economic arm. It is essential that a balance be held between war in the field and war in the workshop and the business office.

We are fighting for freedom, but to win freedom we must voluntarily limit our freedom in various ways. Nothing is more useful today than for ordinary citizens to keep a vigilant look-out for waste, inefficiency, carelessness, extravagance, and, when occasion arises, to criticize. Criticism is one of the greatest aids to efficiency; indeed, without it, self-government cannot exist.

We should be vigilant custodians of liberty, jealously on guard to see that restrictions on our liberty are not taken for granted, that they are closely scrutinized, that we seek to have them altered if unnecessary; but equally, that when we are satisfied they are necessary, we accept them in a good spirit.

We should, even now, be preparing for the peace, both in mind and heart. Don't let us, civilians, forget that no enduring peace can be made by men with hatred in their hearts. Hatred is a civilian product; I have never seen it among soldiers, certainly not those in direct contact with the enemy.

There is another thing for us to do—to keep clear in our minds the real nature of this struggle. That is doubly important—important for our morale during the war, and important for our sanity when the time comes to make peace. The Germans under Hitler have gone mad with lust for world domination: civilization would be lost if they should win.

The greatest duty of all is to be calm, courageous and hopeful. It is harder in some ways for us than for the soldiers. They have the advantage of seeing courage and unselfishness constantly displayed. We have not. We lack this inspiration. In a drab and workaday world, it is harder to rise to these heights; yet it is imperatively necessary that we shall. There must, of course, be no moaning and complaining on the home front, and there must be more understanding and mutual helpfulness than in peacetime.

One suggestion I make in aid of steady nerves is that we concentrate on our job. The best means of keeping body and mind fit and tough to resist all shocks is work.

REPORT ON DOMINION-PROVINCIAL RELATIONS

Editor's Note: This is the ninth in a series of notes on economic subjects by Professor McQueen of the University of Manitoba.

THE report of the Royal Commission on Dominion-Provincial Relations is not of course getting the official attention it properly deserves nor is the public likely to take time out to read it. That such a clear, well-written and significant document is in danger of being consigned to academic oblivion for the duration reveals how really critical are the days in which we live. This document may disappear for the duration but re-appear again it will, for the illness it diagnoses is not a temporary indisposition. The recommendations of the report involve a return to the concept of the Fathers of Confederation. They did not intend that provinces should be mere municipal units nor did they intend that they should become rivals in sovereignty with the federal government. The recommendations of the report could be said then to represent a return to 1867 rather than a departure from it.

Volume I of the report, besides presenting the best economic history of Canada since 1867 that has ever been produced, lays down the general principles which must guide all intelligent thought on the solution of the problem of Dominion-Provincial relations. Volume II presents the specific recommendations of the commissioners working within the general principles laid down in Volume I. These two volumes should be required reading for every Canadian who really believes in democratic institutions. Our liberties and privileges were won at a price and they will only be preserved by vigilance and intelligence. In the underlying philosophy of this report lies the true source-stuff of Canadian democracy. The illness that had fallen upon the nation is clearly set out. An expansion in the functions of government which was inevitably associated with the growth of industrialism, the world exchange-economy and a growing sense of social responsibility for what were manifestly socially-generated problems had laid new and costly duties upon both federal and provincial governments. The social welfare activities of governments increased more than in proportion to national growth and the plan of confederation had allocated revenues and functions according to the conditions as they were in 1867. Canada became one of

the world's great trading nations subjected to every oscillation of business activity across the world and the social consequences of these oscillations were largely a charge upon provincial governments. The true situation was disguised so long as the Canadian economy was expanding but after the war the slackening in this rate of expansion and the world depression revealed the difficulty with unmistakable clarity. A world depression hit with full force on those parts of Canada dependent on export for their life—and one-third of Canada's production is for export.

The blow of the depression impinged with varying severity on the different parts of Canada and destroyed the capacity of some of the provinces to perform the functions allocated to them. When allocated provincial revenues were insufficient to carry out allocated provincial functions it seemed that either an increase in revenues or a decrease in functions would provide a solution. But to add enough to the revenue sources of the poorest provinces to allow them to carry on their allotted functions would in many cases add very little revenue and would certainly add unneeded revenues to the richer provinces while to reduce the functions of provinces would reduce provincial sovereignty to a degree that would leave Canada a unitary and not a federal state. And for sound political reasons Canada could not continue to exist except as a federal state. The solution presented in the report consists of a shuffling of some revenues and some functions as between the central and the provincial governments. There is also provided necessary machinery for continuous adjustment based on continuous survey of economic conditions in the various regions of Canada. The general argument for the implementing of the report is that the federation cannot continue unless something along the recommended lines is done. It is also shown that the removal of present restrictions to Canadian economic effort by the implementing of the report would be appreciable. The report is an eloquent and reasoned document of which Canadians may be proud. It should be on the "must" list for summer reading.

R. McQueen.

20th June 1940.

THE SOCIETY OF CHARTERED ACCOUNTANTS OF THE PROVINCE OF QUEBEC

Report of the Sixtieth Annual Meeting

THE sixtieth annual meeting of the Society of Chartered Accountants of the Province of Quebec was held in the Royal Bank building, Montreal, at 10.30 a.m. Thursday, 20th June 1940, with President Alex. Ballantyne presiding.

President Ballantyne's Address

Gentlemen:

It is just a year ago since I was honoured by election to the presidency of this Society. While thoughts of war were not entirely non-existent at that time, such thoughts were more or less relegated to the back of our minds as being not of immediate concern. Within a very few months, however, conditions were such that we could no longer consider the possibility of war as being in the distant future, and very soon the possibility became a certainty and we found ourselves again fighting side by side with the rest of the British Empire and the Republic of France in defence of democracy and of all the things that are necessary to the life of a democratic people.

It is, I think, safe to say that in no similar period of time has such a drastic change been effected in the lives of so many people. Within a period of a few months we have seen the occupation and devastation of Czechoslovakia, Poland, Finland, Norway, Holland, Belgium and France, and there is grave danger of the British Isles also being subjected to invasion.

In view of these momentous happenings it seems at first glance that matters affecting our individual lives and the affairs of our business, social and other organizations pale into insignificance and that they might very well be allowed to fall by the wayside, with the excuse that there are other and more important matters requiring our attention. I agree that no effort should be spared by any of us to further our Country's war effort, but I believe that there should still be available sufficient energy to be devoted to the maintenance of those societies which are necessary to the proper functioning of our business and social activities during normal time. So long as we maintain pride in our

civil organizations and refuse to allow them to die from neglect, we serve notice to the world of our faith in the future. In spite of all that has happened in the past few months and of additional hardships and possible further disasters to come, I believe that the might of the British Empire joined with that of France and fighting on the side of right and justice must prevail, and that any other ending of the present hostilities is unthinkable.

I think I can truly say that the affairs of your Society have not been neglected during the past year and that members of council have, as in the past, given unsparingly of their time and effort in the discharge of their duties. To those members of council who retire from office today I offer my sincere thanks for the assistance rendered to me during my term of office, and to those who are continuing in office for another year I also wish to express my thanks and to enlist their continued support, together with that of the newly elected members of council, to my successor in office.

I feel that the Society is to be congratulated on its selection of executive officers for the coming year.

Mr. Elderkin has consented to act as Secretary-Treasurer for another year, and I am sure I am voicing the opinion of all members of council when I say that the duties of that office have been carried out most efficiently and that the Society is deeply indebted to Mr. Elderkin for the capable manner in which he has taken over the manifold duties attaching to this office.

As Second Vice-President for 1940-41 we have been fortunate in obtaining Mr. Alfred Smibert. Mr. Smibert has had several years of experience as a member of council and has always taken a keen interest in the affairs of the Society. His election to this office is a well merited honour.

Mr. Wm. H. Campbell will hold the office of First Vice-President having served as Second Vice-President in the past year. Mr. Campbell has already given excellent service to the Society and his keen interest and wise counsel have been a source of strength to the Executive.

Before handing over the reins of office to the new President I would like to say that I have deeply appreciated the honour of presiding over the affairs of your Society for

the past year. I have thoroughly enjoyed the experience and the opportunities thus given me of knowing more intimately many of our members. If I have been able to render services of value to the Society and to the profession, I can assure you that that is ample recompense for the time and effort expended.

It is now my very pleasant duty to vacate this chair in favour of the new President, Mr. Henry G. Norman. Mr. Norman is so well known to most of you that to speak of introducing him seems entirely out of place. I would, however, like to emphasize the good fortune of the Society in having a man of Mr. Norman's ability available and willing to accept the office of President. I frankly believe that he is the busiest man I know and yet he always seems to be able to take on new duties, and somehow to find the time to carry them out. In addition to being an executive officer of our Society for the past two years, Mr. Norman has been a member of the Executive Committee of The Dominion Association of Chartered Accountants and Chairman of its Legislative Committee, and since the commencement of the war he has spent a considerable part of his time in rendering services to various departments of the government in Ottawa.

Mr. Norman, it gives me very great pleasure to welcome you to the Presidency of this Society. I know the Society is going to benefit by your service in this capacity, and I sincerely hope that your term of office will be as happy as mine has been. *(applause)*

Address of President-Elect Henry G. Norman

Gentlemen:

It is with considerable pride and also with a serious feeling of responsibility that I assume the reins of office as President of this Institute, to which position I have been elected today.

Firstly I would like on your behalf to pay a tribute to Mr. Ballantyne for the unremitting energy which he has given in carrying on the work of the Presidency of this Institute during the past year. It has been a progressive year, particularly having regard to educational matters, and I think there are very few of those present who realize the tremendous amount of work and time which Mr. Bal-

lantyne has devoted to the affairs of this Institute and in addition to the affairs of The Dominion Association of Chartered Accountants in which he was our representative on the board of examiners-in-chief.

Normally I would feel very hesitant in taking over the responsibility as the President of this Institute, particularly having regard to educational work, but I feel reasonably confident in view of the fact that Mr. Ballantyne will be still on the Council for the coming year. I believe the duties of a good executive are to pass on his responsibilities to others and, although Mr. Ballantyne may be relinquishing his office as President, I think he will probably be called upon by me to continue to carry on, together with the other members on the incoming Council, a considerable amount of the work of this particular nature.

These days are fraught with conditions which we a year ago never anticipated could exist, and we undoubtedly turn over in our minds constantly the question, "What can we do to help our country and the Empire in the grave position in which they find themselves at the present time?"

There are of course many of the members of our Institute serving with the Canadian Forces; some of them are in high command, others are doing yeoman service in governmental positions at Ottawa, and at other points are taking upon themselves responsibilities which they probably never dreamed of a year ago. Other members are helping equally as much by carrying on from day to day the duties of civilian life, being ready at all times to do anything which they may be called upon to perform for and on behalf of our government.

The other day I was asked in Ottawa how it was possible that the British Empire succeeded in winning the last war without the help of accountants since wherever one turns in Ottawa today an accountant seems to be assuming a position of responsibility. My reply was that the accountants were doing a great deal of the work in the last war but as usual they were hiding their light under a bushel!

We must, however, guard against one thing and that is assuming unto ourselves attributes which we do not possess. I find that when difficult situations arise some of our government executives appear to think that the calling in of an accountant is a cure-all for such difficulties. Some

of these difficulties are of such a nature that we should not assume the responsibility of trying to solve them without the aid of those who are probably more conversant with the immediate problem.

I particularly want to tell you today of one effort which has been made by our profession in the Dominion when it was asked to supply a group of men to act as a nucleus for the formation of a Pay and Accounting Service in the Royal Canadian Air Force. After working out the details of that service with the responsible officers in the R.C.A.F., I was asked to obtain sixty chartered accountants, of whom half were to be available at the end of this month and half at the end of July. I am delighted to be able to tell you that we have had more applications for appointment to the force to carry out this work than we can accept, and this Institute alone is providing sixteen out of the sixty. The remainder are spread throughout every province of the Dominion, and I feel that this activity will be one which we shall be able to look upon with pride as a national service which we as a profession have been able to render.

To try to solve the problem as to what each one of us can do, I can only answer that in three ways.

Firstly, we are a profession which deals with facts; therefore let us avoid rumours, and when we hear them endeavour to spike them and stick to the facts which are known.

Secondly, let us carry on our day-to-day work which is essential to the economic life of the country as well as essential to the government in order that it in turn may carry on and have the requisite knowledge on which to base its programme; at the same time let us stand ready at any time we are called upon to do those things which the government may ask us.

Thirdly, let us do as instructed by His Majesty the King in his speech over the radio a few days ago, namely, "go about our business with our heads held high and with a smile." *(applause)*

Report of President and Council

The report of the President and Council was presented by C. F. Elderkin, Honorary Secretary-Treasurer. It showed that the Society had a successful and progressive year, among the important events being the participation in uni-

form examinations of the profession throughout Canada, further expansion of the Society's library facilities, continued activity of the students' educational programme, and the inauguration, by an amendment of its charter, of a benevolent fund for members. After transferring $1238 from current revenue to this fund, the excess of income over expenditure of the Society for the year ending 31st May 1940 was $134.26.

Gift to Dominion Government

The President informed the members that the annual meeting of The Dominion Association of Chartered Accountants is being held in Montreal in September of this year, and that the Quebec Society would normally act as host to delegates and visiting members. Due to the state of war now existing, all social activities in connection with this convention are to be cancelled, and in view of the savings thus effected the members approved a gift of $2,500 to the Consolidated Fund of the Dominion of Canada to be devoted to such purposes as the Government deems best.

Officers for 1940-41

The following officers and members of council were elected for the year ending 31st May 1941: President, H. G. Norman; First Vice-President, Wm. H. Campbell; Second Vice-President, Alfred Smibert; Honorary Secretary-Treasurer, C. F. Elderkin; members of Council *for one year*—C. N. Knowles and C. G. Wallace; members of Council *for two years*—H. W. Blunt, L. P. Leduc, D. L. Ross, W. O. Sharp and J. A. Towner. Other members of council who have another year to serve are C. B. Brown, F. E. H. Gates, and Col. P. F. Seymour, and Alex. Ballantyne as immediate Past President—making a total of fifteen.

GENERAL NOTES

Our Contributors This Month

The Editorial Committee wishes to acknowledge the kind assistance of Professor R. G. H. Smails again this summer in the preparation of the editorial comments of the July, August and September issues.

V. Randolph Clerihue, who writes this month on the organization and administration of municipalities in British Columbia, has contributed to our pages on several occasions. Amongst his earlier contributions are articles on the accounts of an automobile distributor, an air transportation company and time sales financing companies.

Table of Exchange Rates

(Kindly supplied by The Canadian Bank of Commerce, Toronto)

	31st May 1940	*15th June 1940*
U.S. Dollars	10-11% P.	10-11% P.
Sterling	443-447	443-447
Australian Pounds	358½	358½
New Zealand Pounds	360	360
South African Pounds	446	446
Belgium—Belgas	No quote	No quote
Denmark—Kroner	No quote	No quote
Holland—Florins	No quote	No quote
Finland—Finmarks	218	220
France—Francs	200	252
Italy—Lire	560	No quote
Sweden—Kronor	2635	2635
Switzerland—Francs	2478	2478
Norway—Kroner	No quote	No quote

Note: The above quotations are expressed as follows: Pound currencies—Canadian cents per unit; Continental currencies—Canadian cents per 100 units.

Chartered Accountants and the War

Flying Officer James Kerr, Calgary, is now serving with the Requirements Section of the Directorate of Postings and Records in the Royal Canadian Air Force, Ottawa.

Lieutenant Arthur Maw, Calgary, is stationed at Winnipeg with an artillery unit of the Canadian Active Service Force.

Accountants and National Service

In our issue of April last (page 282) reference was made to the fact that at the time of the Executive Committee meeting in February 974 members had filled in the national service registration form supplied by the Association to members about a year ago. The completed forms were filed with the Comptroller of the Treasury at Ottawa for the reference of all government departments.

Within the past week or two, more forms are being sent in to us for filing. Members who have not yet filled one but wish to do so should apply to the Secretary of their local Institute for blank forms. The form (in duplicate) should be posted to the Secretary-Treasurer, The Dominion Association of Chartered Accountants, 10 Adelaide Street East, Toronto.

Accounting Research Studies

The Executive Committee of our Association and in fact the whole profession in Canada are very greatly indebted to the American Institute of Accountants for the kind permission extended to us of publishing in THE CANADIAN CHARTERED ACCOUNTANT Research Bulletins 5 and 6 entitled *Depreciation on Appreciation* and *Comparative Statements* respectively. The Bulletins have just recently been issued by the Research Committee of the Institute.

Customs and Excise Revenue

The following comparative statement of net receipts for the fiscal years ending 31st March 1939 and 31st March 1940 is taken from *The National Revenue Review,* the monthly publication of the Department of National Revenue, Ottawa. A decrease from the previous year is indicated by an asterisk.

	1938-39 (thousands of dollars)	1939-40 (thousands of dollars)	Increase or Decrease
Customs duties—net	$ 78,458	$100,906	$22,448
Excise taxes—net	161,721	166,028	4,307
Excise duties—net	51,649	64,424	12,775
Sundry collections—net	718	611	*107
	$292,546	$331,969	$39,423

Dominion Income Tax Collections

The *Review* reports net income tax collections under the *Income War Tax Act* during the fiscal year ended 31st March 1940 as $134.4 millions. This was a decrease of $7.6 millions from collections of the 1938-39 period which amounted to $142 millions. It is interesting to note that net collections for the fiscal year ended 31st March 1939 exceeded those of the preceding year ended 31st March 1938 by $22 millions.

Bankruptcy In Canada

According to the last annual report of the Superintendent of Bankruptcy, the number of bankruptcies in Canada continues at about the same level as for the previous four years. During 1938 the volume of business reached approximately ninety per cent of the average of the pre-depression period but, as statistical economists claim, more bankruptcies occur with improvements in business conditions owing to the greater risks then being taken to share in the general prosperity and the greater freedom of credit.

Part of the report is devoted to a discussion of certain practices designed to evade the provisions of *The Bankruptcy Act.*

"Bankruptcy administration," states the report, "has always been subjected to adverse and subversive influences and there have always been attempts to evade and circumvent its provisions. However, as *The Bankruptcy Act* was amended and strengthened from time to time the opportunity for evasion within the Act was largely eliminated with the result that those responsible for these evasions and subterfuges were compelled to find some other scheme of operation. Among such alternative devices the power of attorney unconditionally authorizing the appointee to sell and dispose of the debtor's assets and to distribute the proceeds among his creditors seems to have been most frequently employed during the last few years. In other cases similar results are obtained by means of fictitious and fraudulent bulk sales. There are undoubtedly many cases in which proceedings under power of attorney, bulk sale or proceedings of a similar nature are honestly and efficiently carried out but in the absence of supervision and effective control a greater opportunity exists for fraud.

"From a small beginning these practices have grown to the extent that they have seriously encroached upon the field of bankruptcy administration and have become an alternative device to bankruptcy with, as it not infrequently happens, very little regard to the rights of the debtors and creditors concerned. Collective action by creditors is rarely possible and there is not the inducement provided by *The Bankruptcy Act* for individual creditors to take action on behalf of all creditors. It is only when some sufficiently resolute creditor or creditors oppose the proceedings that the *modus operandi* in such cases are exposed.

"One of the chief reasons advanced to persuade creditors to join in such proceedings is that the costs of liquidation are reduced. The fundamental objection against all such methods of administering insolvent estates is that the established safeguards under existing legislation for the protection of creditors against questionable and illegal practices are disregarded. The successive amendments to *The Bankruptcy Act* indicate what steps have been taken from time to time to provide definite safeguards to prevent dishonesty and fraud not only by debtors and creditors but by trustees as well. Similar safeguards are equally essential in the administration of insolvent estates by any other method. Otherwise the creditors will constantly be under the uncertainty of never knowing to what extent their legal rights are jeopardized or disregarded. Any reduction of costs obtained in this way is accordingly false economy because any alleged saving will in the long run be far more than offset by the losses sustained by the creditors through fraud and infringement of their legal rights."

Copies of the 1938 report are obtainable from The King's Printer, Ottawa, price ten cents.

Comments and Descriptions in Annual Reports of Corporations

The following comments and descriptions have appeared in recent financial statements of companies incorporated in Canada.

The publication of such comments here from time to time is not necessarily to be regarded as approval or criticism of the

form thereof by the Editorial Committee or by The Dominion Association of Chartered Accountants, but rather as interesting information for readers.

1. The following is the auditors' report to the shareholders of *Aluminium Limited* on the consolidated balance sheet of the company and its fully owned subsidiaries as at 31st December 1939:

We have examined the consolidated balance sheet of Aluminium Limited and its fully owned subsidiary companies except Aluminum Power Company, Ltd. as at 31st December, 1939, and the relative consolidated statements of profit and loss and surplus. In connection therewith we examined or tested accounting records of Aluminium Limited and its Canadian subsidiaries and have been furnished with financial statements as at 31st December, 1939, of subsidiary companies operating outside of Canada whose books and accounts have been examined by independent auditors to varying dates within the year, and have received all the information and explanations we have required.

The detail transactions of the Canadian companies are examined by the companies' internal auditors whose reports are furnished to us. We made a general review of the accounting methods and of the operating and income accounts of those companies for the year, but did not make a detailed audit of the transactions. We have satisfied ourselves that the inventories of aluminium and other products are valued at cost, which was below their market value at 31st December, 1939, and that the inventories of materials and supplies are stated at the lower of cost or market. Inter-company profits have been excluded from inventories.

The surpluses of the individual companies included in the consolidation are subject to such restrictions as to distribution as may be imposed by exchange regulatory bodies of the countries in which the companies are domiciled. Full provision has been made for the investments and other assets in enemy territory.

On the above basis, we report that the attached consolidated balance sheet is, in our opinion, properly drawn up so as to exhibit a true and correct view of the combined state of affairs of Aluminium Limited and its fully owned subsidiary companies except Aluminum Power Company, Ltd. as at 31st December, 1939, according to the best of our information and the explanations given to us, and as shown by the books of the companies examined by us and the financial statements above referred to; and that the relative consolidated statements of profit and loss and surplus fairly present the results of their combined operations for the year ending 31st December, 1939.

Pursuant to Section 114 of the Companies Act, 1934, we report that the profits and losses for the year of the subsidiary companies not consolidated have been included in the consolidated accounts only to the extent of dividends declared and that your Company's share of the aggregate of the profits and losses of these subsidiaries for the year exceeded the amount of such dividends. At 31st December, 1939, there was, in the aggregate, a net balance at the credit of these subsidiary companies' surplus accounts, of which your Company's share since acquisition was \$.... excluding the accumulated deficit of one subsidiary company, the investment in which was previously written off.

2. The auditors' report to the shareholders of *The Canadian Fairbanks-Morse Company Limited* on the balance sheet of the company as at 31st December 1939 is as follows:

We have examined the books and accounts of The Canadian Fairbanks-Morse Company Limited for the year ending December 31, 1939, at the Head Office in Montreal, and have been furnished with returns from the various Branches, certified by the Managers, and with all the information and explanations which we have required.

The inventories of stocks on hand at December 31, 1939, have been certified by responsible officials of the Company, and provision has been made for any loss on all outstanding accounts receivable now considered bad or doubtful.

The Cash and Investments at Head Office have been verified by us, and the bank balances of the Branches reconciled with certificates received from the Company's Bankers. So far as we can determine, all liabilities of the Company at December 31, 1939, have been taken up on the books at that date and are reflected in the attached accounts.

We report that, in our opinion, the attached Balance Sheet at December 31, 1939, is properly drawn up so as to exhibit a true and correct view of the state of the Company's affairs, according to the best of our information and the explanations given to us and as shown by the books and certified Branch returns of the Company.

The Assets and Liabilities of E. & T. Fairbanks and Company Limited, a subsidiary company, are not included in the attached statement and in accordance with Section 114 of the Companies Act, 1934, we report that the profit earned by that subsidiary during the year ending December 31, 1939, has not been taken up in the attached statements, but is carried forward in the accounts of the subsidiary.

3. The auditors' report to the shareholders of *International Metal Industries Limited* on the balance sheet as at 31st December 1939 is as follows:

We have examined the above consolidated balance sheet as at 31st December, 1939, in which assets and liabilities in the United States are included at par of exchange. Subject thereto we report that, in our opinion, it is drawn up so as to exhibit a true and correct view of the state of the affairs of International Metal Industries Limited and its subsidiaries as at 31st December, 1939, according to the best of our information, the explanations given us and as shown by the books of the companies. We have received all the information and explanations we have required.

4. The auditors' report to the shareholders of *Dominion Woollens & Worsteds, Limited* on the balance sheet of the company as at 31st December 1939 is as follows:

We have conducted a balance sheet audit of the accounts of Dominion Woollens & Worsteds, Limited as at 31st December, 1939, and have received all the information and explanations we have required.

The Board of Directors, by resolution, has made provision for depreciation in the amount of $.......... for the year ended

31st December, 1939. No provision was made in respect of the years ended 30th June, 1935, and 31st December, 1938.

The inventories were determined from perpetual book records in the absence of a physical stock-taking.

Subject to the foregoing, in our opinion the above Balance Sheet has been properly drawn up so as to exhibit a true and correct view of the state of the Company's affairs as at 31st December, 1939, according to the best of our information and the explanations given to us and as shown by the books of the Company.

5. Following is the auditors' report to the shareholders of *Ford Motor Company of Canada, Limited* on the balance sheet as at 31st December 1939:

We have made an examination of the balance sheet of Ford Motor Company of Canada, Limited as at December 31st, 1939 and of the related statements of income and expenditure and earned surplus for the year ended that date. In connection therewith we made substantial tests during the year of accounting records at the head office and obtained all the information and explanations we required from the company's officers and employees; we also made a general review of accounting methods and reviewed the reports from the company's audit department on the test audit of accounting records at branches.

We report that in our opinion the accompanying balance sheet and related statements of income and expenditure and earned surplus have been drawn up so as to exhibit a true and correct view of the state of the company's affairs at December 31st, 1939 and of the results of its operations for the year ended on that date according to the best of our information, the explanations given us and as shown by the books.

As required by the Dominion Companies Act, Section 114, we report that net profits of subsidiary companies for the year ended December 31st, 1939 have been taken into account only to the extent of the dividends received from those companies as shown in the statement of income and expenditure and in the aggregate were in excess of such dividends.

6. The auditors' report to the shareholders on the consolidated balance sheet as at 31st December 1939 of *Ontario Silknit Limited* and its subsidiaries is as follows:

We have made an examination of the consolidated balance sheet of Ontario Silknit Limited and subsidiary companies as at December 31 1939 and of the consolidated statement of profit and loss for the year ending on that date. These statements include the assets and liabilities and results of operations of the English and Australian subsidiary companies as taken from the statements reported on by the auditors of these companies; the net assets of these two subsidiaries, which represent approximately 52% of the total net assets included in the consolidated balance sheet, are subject to such restrictions as to distribution as are or may be imposed by exchange regulatory bodies in England or Australia.

In connection with the accounts of Ontario Silknit Limited and Summit Dyeing Company Limited, one of its Canadian subsidiaries, we examined or tested accounting records and other

supporting evidence and obtained all the information and explanations which we required; we also made a general review of the accounting methods and of the operating and income accounts of these two companies for the year, but our examination of the detail transactions was limited to a test thereof. We were furnished with audited statements as at December 31 1939 of one relatively unimportant Canadian subsidiary, the figures of which are included in the attached statements but whose accounts we did not examine.

We report that, in our opinion, based upon our examination, and subject to the adequacy of the accumulated reserve for depreciation of fixed assets set up by Ontario Silknit Limited and Summit Dyeing Company Limited, the attached consolidated balance sheet (in conjunction with the appended notes relative thereto) is properly drawn up so as to exhibit a true and correct view of the combined state of affairs of Ontario Silknit Limited and subsidiary companies as at December 31 1939 according to the best of our information and the explanations given to us and as shown by the books of the companies examined by us and by the audited statements of the three subsidiary companies referred to above.

7. Following is the auditors' report to the shareholders of the *Dominion Textile Company, Limited* on its balance sheet as at 31st March 1940:

We have audited the books of account of Dominion Textile Company, Limited for the year ended 31st March, 1940, and have obtained all the information and explanations that we have required.

In accordance with Section 114 of the Dominion Companies Act, 1934, we report that (1) the aggregate profits, less losses, of Subsidiary Companies are reflected in the Profit and Loss Account of Dominion Textile Company, Limited only to the extent that dividends have been received, (2) in respect of one Subsidiary Company, its loss for the year, amounting to . . . . , has been added to its accumulated deficit, and no provision for this loss has been made in the accounts of Dominion Textile Company, Limited.

In view of the expansion in export business and the increased volume of domestic business the management has made an additional provision of $350,000.00 in the operating accounts of the Company for increased risks of collection under present day conditions.

We report that, in our opinion, the attached Balance Sheet and relative Profit and Loss and Earned Surplus Accounts are properly drawn up so as to set forth correctly the financial position of Dominion Textile Company, Limited as at 31st March, 1940, according to the best of our information and the explanations given to us and as shown by the books of the Company.

8. The auditors' report to the shareholders of *Standard Chemical Company Limited* on the consolidated balance sheet of the company and its subsidiaries as at 31st March 1940 is as follows:

We have examined the consolidated balance sheet of Standard Chemical Company Limited and subsidiary companies (exclusive of Wood Products Company, Limited) as of March 31 1940 and the consolidated statement of profit and loss for the year then ended

and have obtained all the information and explanations we have required. In connection therewith we examined or tested accounting records of the companies and other supporting evidence but our examination of the detail transactions was confined to limited tests thereof.

In accordance with section 114 of The Companies Act 1934 we report that since the investment in the capital stock of and advances to its subsidiary Wood Products Company, Limited have been written down on the books of Standard Chemical Company Limited to $1.00, it has not been considered necessary to record further losses of Wood Products Company, Limited in the accounts of the parent company.

We report that the attached consolidated balance sheet and related consolidated statement of profit and loss are, in our opinion, properly drawn up so as to exhibit a true and correct view of the state of the affairs of the combined companies as of March 31 1940 and of the results from operations for the year ending on that date, according to the best of our information and the explanations given to us and as shown by the books of the companies.

9. The auditors' report on the balance sheet of *International Harvester Company* as at 31st October 1939 is as follows:

We have examined the consolidated balance sheet of International Harvester Company (a New Jersey Corporation) and affiliated companies as of October 31, 1939 and the summary of consolidated income and surplus for the year ended that date, and, as to the companies other than eleven foreign affiliated companies, have reviewed the systems of internal control and the accounting procedures and have examined or tested accounting records and other supporting evidence by methods and to the extent we deemed appropriate. Our examinations of inventories included physical tests of quantities. As to the eleven foreign affiliated companies not examined by us, we reviewed the companies' annual reports (supplemented by reports of other public accountants on the six principal companies), and the accounts of these companies are included in the accompanying statements on the basis of such reports; the total assets, sales, and net income of these companies amount to approximately 8%, 11%, and 11%, respectively, of the consolidated totals.

The accompanying summary of consolidated income and surplus includes the earnings of the companies operating in the southern hemisphere for a fiscal year ended June 30, 1939, and the estimated earnings of such companies from June 30 to October 31 are classified as deferred credits in the accompanying balance sheet.

In the preparation of the consolidated balance sheet at October 31, 1939 the foreign net current assets in three countries imposing severe exchange restrictions were included at rates which were substantially lower than quoted rates.

In our opinion, based upon our examination and upon the annual reports of foreign affiliated companies not examined by us, the accompanying consolidated balance sheet and related summary of consolidated income and surplus fairly present the financial condition of the companies at October 31, 1939 and the results of their operations for the fiscal year, in accordance with generally accepted accounting principles followed by the companies on a basis consistent with that of the preceding year.

LEGAL DECISIONS

[EDITOR'S NOTE: The following are brief summaries of recent decisions of the Canadian Courts as taken, by the kind permission of the Canada Law Book Company, from the *Dominion Law Reports*. In each case reference is made to the volume of the *Reports* where the full judgment may be found. It should be kept in mind that the decisions given may not in every case be final.]

Sales tax—Contract with provincial government for erection of bridge—Materials incorporated in bridge

(The King v. *Dominion Bridge Co.)*

Supreme Court of Canada

Materials manufactured for the express purpose of being incorporated in a bridge to be erected by the manufacturer under a contract with the provincial Government are "goods" manufactured "for use by the manufacturer and not for sale" within the meaning of s. 87(d) of the *Special War Revenue Act,* R.S.C. 1927, c. 179, but in virtue of such provision the transaction is deemed to be a sale and, since the manufacturer's "use" of the goods in fulfilling his contract involves a translation of the property in such goods to the provincial Government under the contract, the goods are sold to the provincial Government, and hence the manufacturer is entitled under s. 105 to a refund of sales tax paid in respect of such materials.—[1940] 2 D.L.R. 545.

(*Note*: A reference to the judgment of the Exchequer Court of Canada in this case was published in the February 1940 issue of THE CANADIAN CHARTERED ACCOUNTANT.)

Taxes (Sask.) — Appeals from income tax assessment—Extra-provincial companies—Taxation on estimate of income within province—Whether direct taxation—"Amount received" from sales—Deductions for bad debts

(Re International Harvester Co.)

Saskatchewan Court of Appeal

The principle that the provisions of particular statutes are impliedly excepted from the provisions of general statutes only applies where there is conflict or inconsistency. Thus the provisions of the *Income Tax Act,* 1932 (Sask.), c. 9 (am. 1934-35, c. 16), whereby income tax appeals from the decisions of the Board of Revenue Commissioners lie only to a Judge of the King's Bench, are impliedly excepted from the general appeal provisions of the *Treasury Department Act,* 1938 (Sask.), c. 8, whereby appeals lie, on a

question of law, from the decisions of the Board to a Judge of the King's Bench and thence to the Court of Appeal. But the general appeal provisions of the *Treasury Department Act,* apply to income tax appeals in respect of incomes governed by the *Income Tax Act,* 1936 (Sask.), c. 15, for the repeal by 1938, c. 91 of ss. 58 and 58a of the 1936 Act, whereunder income tax appeals on the merits lay from the Board to a Judge of the King's Bench and thence to the Court of Appeal, left no particular legislation creating an exception from the general appeal provisions of the *Treasury Department Act* in respect to decisions of the Board upon income tax appeals.

The provisions of the *Income Tax Act,* 1936 (Sask.), c. 15 in relation to the taxation of extra-provincial companies carrying on business in the Province evince an intention to impose only "direct taxation within the Province" and hence are not *ultra vires.* While a tax imposed under s. (94) and the regulations thereunder, whereby in the absence of information as to the company's income in the Province, its income shall be deemed to be such percentage of its total income as the percentage of its sales in the Province bears to its total sales, is not a tax on income, it is nonetheless direct taxation within the Province.

In determining the "gross amount which the taxpayer has received from sales" for the purpose of fixing the taxpayer's income within the Province for taxation pursuant to s. 9(4) of the *Income Tax Act,* 1936 (Sask.), c. 15 and the regulations thereunder, the expression "amount received" is to include not only money but also receivables, as notes, book debts, etc.

In determining a taxpayer's income for taxation purposes under the *Income Tax Act,* 1936 (Sask.), c. 15 deductions are allowable in respect of bad debts contracted in the year under review but not for bad debts contracted in previous years, and under s. 6(d) of the Act the Commissioner shall allow the taxpayer to set aside out of profits a reserve for future bad debts, and his discretion must be exercised upon sound principles. So where the Commissioner, instead of allowing a reserve to be set aside for future bad debts allowed deductions for bad debts contracted in previous years, held, the assessments must be remitted to the Commissioner for re-assessment.—[1940] 2 D.L.R. 646.

(*Note*: A previous reference to this case was published in the March 1940 issue of THE CANADIAN CHARTERED ACCOUNTANT.)

STUDENTS' DEPARTMENT

R. G. H. SMAILS, C.A., Editor

Notes and Comment

Amongst the many minor causes of constitutional creaking and groaning which were brought to the attention of the Royal Commission on Dominion-Provincial Relations was the lack of uniformity in the companies acts of the ten jurisdictions endowed by the B.N.A. Act with power to incorporate companies. The Commission points out (*Report*, Book II, page 56) that uniformity could, of course, be achieved automatically by transfer to the Dominion of sole jurisdiction to incorporate companies. It feels however that there is a proper field for provincial incorporation of companies, that the present system of provincial incorporation is operating satisfactorily to the convenience of the public and that it should not be disturbed.

Although the Commission thus rejects one theoretical method of establishing absolute uniformity it places itself on record as believing that the advantages of substantial uniformity in the ten companies acts would be very great and, by implication, that this could be achieved in spite of the existence of the two widely divergent methods of incorporation — the memorandum of association used in British Columbia, Alberta, Saskatchewan and Nova Scotia and the letters patent employed in the other jurisdictions. The Commission therefore gives its blessing to the approach adopted by the Dominion-Provincial Conference of 1935, regarding this as the most practicable method of dealing with the matter. This Conference appointed a sub-committee on company affairs which met several times and prepared and circulated a draft uniform act, but which has not, so far as we are aware, been recently active. The Commissioners conclude their discussion of this topic: "We . . . . urge upon all parties the desirability of achieving, as speedily as possible, substantial uniformity of company law in all jurisdictions."

* * *

The Commissioners proceed to consider (*Idem*, page 57) the related problem of diversity in the licensing regulations of the several jurisdictions and condemn what seems to

them to be "a useless duplication of labour and expense in having substantially the same information supplied in different forms to the various jurisdictions in which a company desires to sell securities." They recommend that either the investigation and licensing of one jurisdiction should be accepted by all or else that all jurisdictions should adopt a common form of application for permission to issue and sell securities. Progress along these lines can best be made, they again think, through the machinery of the Dominion-Provincial sub-committee on company affairs.

* * *

STUDENTS' ASSOCIATION NOTES

ALBERTA

Flying Officer T. G. Brown is now stationed at the Royal Canadian Air Force training school at St. Thomas, Ontario.

Sergeant A. D. MacKenzie is on active service with the Southern Alberta Regiment.

ONTARIO—Toronto

At the time of writing the Students' Association's baseball season is almost at an end. This year some ten teams have been playing, and although the start of the schedule coincided with the beginning of Toronto's rainy season, with unfortunate results, nevertheless enthusiasm has increased this year, and the ability of the players has also improved considerably. At present those who are not chasing baseballs are hitting golf balls in preparation for the annual golf tournament.

The attention of students is directed to the tennis tournament, which will begin shortly after July 1st. There will, therefore, still be time to enter after this appears in print.

It is rumoured very strongly that an added diversion this summer will be a moonlight cruise. The possibilities here are practically unlimited, so further announcement about this is awaited with interest.

SASKATCHEWAN

The Secretary of the Institute of Chartered Accountants of Saskatchewan reports that the following students of the Institute have enlisted for active service: Captain Eric Bell, Captain F. Defaye, Lieut. Geo. Rooke, Lieut. B. H. Pringle, Lieut. Manson Wells, Flight Lieut. G. Lewis, and R. M. Dill in the Royal Canadian Navy.

PROBLEMS AND SOLUTIONS

Solutions presented in this section are prepared by practising members of the several provincial Institutes and represent the personal views and opinions of those members. They are designed not as models for submission to the examiner but rather as such discussion and explanation of the problem as will make its study of benefit to the student. Discussion of solutions presented is cordially invited.

PROBLEM 1.

THE PROVINCIAL INSTITUTES OF CHARTERED ACCOUNTANTS.

INTERMEDIATE EXAMINATIONS, DECEMBER, 1939

ACCOUNTING II. Question 2.

A and B have been partners for ten years with respective interests of two thirds and one third in all particulars. A desires to retire from the partnership and B and C agree to purchase A's interest.

The following trial balance is to be used in the basis of settlement:

A and B

Trial Balance

As at 31st December, 1938

	Dr.	*Cr.*
Accounts receivable	$104,123.17	
Advertising	25,000.00	
Cash	27,720.83	
Factory buildings	75,000.00	
Factory machinery and equipment	50,000.00	
Finished goods inventory 1st January 1938	67,500.00	
General expenses	12,500.00	
Investment in 5% bonds	10,000.00	
Labour	163,000.00	
Land	15,000.00	
Office rent—Administrative	6,000.00	
Office salaries—Administrative	12,000.00	
Power, heat and light	13,000.00	
Raw materials inventory, 1st January 1938	92,600.00	
Raw materials purchased	156,500.00	
Salesmen's expenses	20,000.00	
Salesmen's salaries	30,000.00	
Supplies inventory, 1st January 1938	5,000.00	
Supplies purchased	7,000.00	
Superintendence, etc.	6,000.00	
Taxes, insurance, etc.	12,500.00	
Accounts payable		$127,944.00
Interest received on bonds		500.00
Sales, net		500,000.00
A's capital		200,000.00
B's capital		100,000.00
A's drawings	12,000.00	
B's drawings	6,000.00	
	$928,444.00	$928,444.00

In determining A's interest the following particulars are to be taken into consideration:

(1) During the term of the partnership of A and B no allowance was made for depreciation of buildings or machinery, nor was any reserve set up for bad debts, the practice having been to write off accounts only when known to be worthless. It is agreed to depreciate the buildings for 10 years at 2% on decreasing values and to depreciate $30,000.00 of machinery for 10 years and $20,000.00 for 3 years at 10% on decreasing values.

(2) It is further agreed between all parties that the assets and liabilities shall consist of:

Assets:

Cash as shown on the trial balance.

Land at book value.

Buildings and machinery at book values less depreciation.

Accounts receivable as shown on the trial balance, except that $2,000.00 is to be deducted for doubtful accounts.

Raw materials as per inventory, $100,000.00.

Finished goods as per inventory, $75,000.00.

Supplies as per inventory, $6,500.00.

Prepaid insurance as per inventory, $3,000.00.

Liabilities:

Accounts payable as shown on the trial balance.

Accrued taxes, $2,500.00.

Accrued wages, $7,500.00.

(3) The goodwill is to be taken as equal to the net earnings for the last three years after taking into consideration the depreciation on buildings and machinery pertaining to these years and the allowance of $2,000.00 during the year 1938 for doubtful accounts. The profits shown by the books for the years 1936 and 1937 amounted to $30,450.19 and $38,287.31 respectively.

From the given particulars prepare the following:

(a) Manufacturing account for the year 1938.

(b) Trading account for the year 1938.

(c) Profit and loss account for the year 1938.

(d) Statement showing balance to be distributed after allowing for the accumulated depreciation of buildings and machinery for the term of partnership.

(e) Statement showing your calculation of depreciation.

(f) Statement showing valuation of goodwill.

(g) Balance sheet as at 31st December 1938, after making all adjustments and taking into consideration goodwill and depreciation. Show net worth as a whole and A's and B's respective interests.

(h) If B and C are to be equal partners in all respects, state the amount of cash that each would contribute toward the purchase of A's interest after turning over all the cash of the old partnership to A in part payment.

SOLUTION

Question 2

A and B.

Manufacturing Account
(a) for the year ended 31st December 1938

Raw material costs:			
Inventory, 1st January 1938	$ 92,600.00		
Purchases	156,500.00		
	249,100.00		
Less Inventory, 31st December 1938	100,000.00	$149,100.00	
Direct labour cost:			
Labour—paid	163,000.00		
Labour—accrued	7,500.00	170,500.00	
Manufacturing expense:			
Supplies	5,500.00		
Superintendence, etc.	6,000.00		
Power, heat and light	13,000.00		
Depreciation of machinery	2,782.26		
Taxes, insurance, etc.	12,000.00		
Depreciation of buildings	1,250.62	40,532.88	
Cost of goods manufactured			$360,132.88
		$360,132.88	$360,132.88

Trading Account
(b) for the year ended 31st December 1938

Sales		$500,000.00
Inventory of finished goods, 1st January, 1938	$ 67,500.00	
Cost of goods manufactured	360,132.88	
	427,632.88	
Less Inventory of finished goods, 31st December, 1938	75,000.00	
Cost of goods sold	352,632.88	
Gross trading profit	147,367.12	
	$500,000.00	$500,000.00

Gross trading profit			$147,367.12
Selling Expense:			
Salesmen's salaries	30,000.00		
Salesmen's expenses	20,000.00		
Advertising	25,000.00	75,000.00	

General and Administrative expenses:			
Salaries	12,000.00		
Rent	6,000.00		
General expenses	12,500.00		
Reserve for bad debts	2,000.00	32,500.00	
Net trading profit		39,867.12	
		$147,367.12	$147,367.12

Profit and Loss Account

(c) for the year ended 31st December 1938

Net trading profit		$ 39,867.12
Interest on bonds		500.00
Net profit for year	$ 40,367.12	
	$ 40,367.12	$ 40,367.12

(d) Statement Showing Balance To Be Distributed

Net profit for year as per profit and loss account			$ 40,367.12
Depreciation, 1929 to 1937 inclusive:			
Buildings	$12,468.91		
Machinery	22,177.38	34,646.29	
Balance to be distributed:			
A, 2/3	3,813.89		
B, 1/3	1,906.94	5,720.83	
		$40,367.12	$40,367.12

(e) Statement of Depreciation of Buildings and Machinery, 1929 to 1938 inclusive.

	Buildings 2%		*Machinery 10%*	
Year	*Balance*	*Depreciation*	*Balance*	*Depreciation*
1929	$75,000.00	$ 1,500.00	$30,000.00	$ 3,000.00
1930	73,500.00	1,470.00	27,000.00	2,700.00
1931	72,030.00	1,440.60	24,300.00	2,430.00
1932	70,589.40	1,411.79	21,870.00	2,187.00
1933	69,177.61	1,383.55	19,683.00	1,968.30
1934	67,794.06	1,355.88	17,714.70	1,771.47
1935	66,438.18	1,328.76	15,943.23	1,594.32
1936	65,109.42	1,302.19	34,348.91*	3,434.89
1937	63,807.23	1,276.14	30,914.02	3,091.40
Total depreciation		12,468.91		22,177.38
1938	62,531.09	1,250.62	27,822.62	2,782.26
Grand total depreciation		13,719.53		24,959.64
Account balances		61,280.47		25,040.36
		$75,000.00		$50,000.00

*$20,000 additional from this point as per agreement.

(f) Statement of Valuation of Goodwill, as at 31st December, 1938.

Profit for 1936:			
As per books		$ 30,450.19	
Deduct Depreciation:			
On buildings	$ 1,302.19		
On machinery	3,434.89	4,737.08	25,713.11
Profit for 1937:			
As per books		38,287.31	
Deduct Depreciation:			
On buildings	1,276.14		
On machinery	3,091.40	4,367.54	33,919.77
Profit for 1938:			
As per statement			40,367.12
Total goodwill			100,000.00
Distributed as follows:			
A, 2/3		66,666.67	
B, 1/3		33,333.33	100,000.00

(g) A and B

Balance Sheet

As at 31st December 1938

ASSETS

Current assets:			
Cash			$ 27,720.83
Accounts receivable		$104,123.17	
Less Reserve for doubtful accounts		2,000.00	102,123.17
Inventories:			
Raw materials		100,000.00	
Finished goods		75,000.00	
Supplies		6,500.00	181,500.00
Total current assets			311,344.00
Investment in 5% Bonds			10,000.00
Property, plant and equipment:			
Land		15,000.00	
Buildings	$75,000.00		
Less Reserve for depreciation	13,719.53	61,280.47	
Machinery	50,000.00		
Less Reserve for depreciation	24,959.64	25,040.36	101,320.83
Goodwill			100,000.00
Deferred charges:			
Prepaid insurance			3,000.00
Total			$525,664.83

LIABILITIES

Current liabilities:			
Accounts payable			$127,944.00
Accrued taxes			2,500.00
Accrued wages			7,500.00
Total current liabilities			137,944.00
Net worth:			
A—Capital		$200,000.00	
Profit		3,813.89	
Goodwill		66,666.67	
		270,480.56	
Less Drawings		12,000.00	
		258,480.56	
B—Capital	$100,000.00		
Profit	1,906.94		
Goodwill	33,333.33		
	135,240.28		
Less Drawings	6,000.00	129,240.27	387,720.83
Total			$525,664.83

(h)

Statement of Retirement of A and Admission of C to Partnership as at 31st December 1938

Net worth of old partnership (entire)			$387,720.83
Amount to be paid to A in settlement			27,720.83
			360,000.00
Distributed as follows:			
B, ½		$180,000.00	
Represented by:			
Present investment	$129,240.27		
Additional amount due	50,759.73		
C, ½—Entirely due		180,000.00	360,000.00
Amount due to A			$258,480.56
Payable from funds of old partnership		$ 27,720.83	
Due from B		50,759.73	
Due from C		180,000.00	258,480.56

NOTE:

In the profit and loss account the allocation of taxes, insurance and depreciation of buildings to factory expense is based on the assumption that these items apply fully to the factory.

THE PROVINCIAL INSTITUTES OF CHARTERED ACCOUNTANTS.

PROBLEM II.

FINAL EXAMINATIONS, DECEMBER, 1939

ACCOUNTING IV. Question 3.

From the following trial balance of a stock brokers' firm prepare a Balance Sheet, Profit and Loss Account and Statement of Capital Position as at March 31, 1939.

For the purpose of margining clients and house accounts twenty-five per cent is to be deducted from the market value of the relative securities.

Your answer should show a general knowledge of the principles involved rather than of the specific requirements of any particular exchange.

Bull, Bear & Company

Trial Balance
as at 31st March 1939

	Dr.	*Cr.*
Bank loan		$ 80,000
Cash on hand	$ 1,000	
Exchange membership	10,000	
Clearings	9,000	
Clients' ledger—Control	120,000	
Furniture and fixtures	4,000	
Reserve for bad debts		5,000
Capital		60,000
Surplus—Balance March 31, 1938		13,000
Unclaimed dividends		3,000
Accounts payable and accrued items		4,000
House account—securities owned	20,000	
Brokerage		29,000
Salaries	18,000	
Rent	3,000	
Telephones, telegraph and tickers	4,000	
Interest—		
Earned		5,000
Paid	3,000	
Miscellaneous office expense	5,000	
Stock exchange dues	2,000	
	$199,000	$199,000

Detail of Clients' Ledger

	Balance		*Market Value of Securities*	
	Dr.	*Cr.*	*Short*	*Long*
Client A	$ 40,000			$70,000
Client B	36,000			40,000
Client C	11,000			12,000
Client D	8,000			4,000
Client E	30,000			60,000

Client F		$1,000		1,000
Client G		4,000	$4,000	
	$125,000	$5,000		

House Account

Securities owned at cost	$20,000
Market value of securities	16,000

SOLUTION

Bull, Bear & Company

Balance Sheet

as at 31st March 1939

ASSETS

Cash on hand		$ 1,000
Clearing house		9,000
Clients (required to margin $13,000.00)		125,000
Securities owned—at cost (required to margin $8,000.00)		20,000
Total current assets		$155,000
Exchange membership		10,000
Furniture and fixtures		4,000
		$169,000

LIABILITIES

Bank loan—secured		$ 80,000
Clients' free credit balance		1,000
Clients' short account (required to margin $1,000.00)		4,000
Unclaimed dividends		3,000
Accounts payable and accrued items		4,000
Total current liabilities		$ 92,000
Reserve for bad debts		5,000
Capital and Surplus:		
Balance as at 31st March, 1938	$ 73,000	
Deduct loss for year per statement attached	1,000	72,000
		$169,000

Profit and Loss Account

For the year ended 31st March 1939

Brokerage		$ 29,000
Interest Earned		5,000
		$34,000
Deduct administration and general expense:		
Salaries	$ 18,000	
Rent	3,000	
Stock exchange dues	2,000	
Telephones, telegraph and tickers	4,000	
Interest paid	3,000	
Miscellaneous office expense	5,000	35,000
Loss for year carried to balance sheet		$ 1,000

Capital Position
as at 31st March 1939

Capital and surplus per balance sheet		$ 72,000
Reserve for bad debts		5,000
		$77,000
Deduct Capital employed in fixed assets:		
Membership	$ 10,000	
Furniture and fixtures	4,000	14,000
		$63,000
Deduct Capital employed in margining:		
Clients' debit balances	$ 13,000	
Clients' credit balances	1,000	
House account	8,000	22,000
Leaving available working capital		$ 41,000

Discussion of Problem Solutions

Accounting I, Question 1 (See June, 1940)

The Editor,
The Students' Department

Dear Sir:

In the first problem in the June issue, the student is asked what procedure he would follow to determine the honesty of the chief accountant of a company. One of the steps recommended in the solution is "Arrange to take possession of all incoming mail, including letters addressed to individuals." This is indefinite and ambiguous. If what is meant is that letters addressed to individuals by name should be seized and opened, this would, I hope, be illegal.

Yours very truly,
Amicus.